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FINANCING THE WAR

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FOREWORD

On November 2 and 3, 1917, the Academy held a Conference in Philadelphia on "Financing the War" and the leading addresses of that Conference are presented as the articles in this issue of *The Annals*. The widespread interest in this meeting was evidenced by the large attendance and also by the appointment of nearly three hundred delegates from states, tax associations, chambers of commerce, colleges and universities and other organizations. To the delegates, to the bodies appointing them and especially to the speakers, many of whom came from a long distance and at much inconvenience, the debt of the Academy is great. Thanks are due also to many individuals in and about Philadelphia for their coöperation. Particular mention should be made of the helpfulness of the Philadelphia Chamber of Commerce and its officials who aided the Academy in every way possible.

THE FINANCIAL SITUATION: A GENERAL SURVEY

By F. W. Taussig,
Chairman, United States Tariff Commission.

Let me begin with a sketch in broad outline of the general situation, a survey of the expenditures which we shall have to face, of our available resources, the prospects for the immediate future and for the more distant future. Nothing more than an approximation to accuracy is now possible; but we can reach an approximation sufficient for an understanding of the tasks and burdens which confront us.

In round numbers, the total appropriations which Congress has made for the fiscal year 1917–1918 come to nineteen billions of dollars. In some of the formal statements the total seems to be much less—no more than twelve billions. But this smaller sum includes only those expenditures which are directly and strictly our own and does not include loans to the allies which are expected to amount to some seven billions of dollars. It has been officially stated that up to October 1 these loans amounted to something over two billions of dollars; we are told to expect five billions more, or a total of seven billions.

The Amount of Funds Provided

Against this imposing sum of nineteen billions we have now provided, or undertaken to provide, perhaps eleven billions. The liberty bonds of the first issue produced two billions. Those of the second issue are expected to provide not less than three, nor more than five billions, and have in fact yielded $4,617,532,300. The total tax revenue, under the provisions of law in effect before the beginning of this year's special session of Congress, amounted to one and one-third billions. The additional revenue under the war revenue act which became law on the third of October is expected to be two and a half billions. In all, therefore, we have provided for something over four billions by taxation and five to seven billions by loans. These are stupendous sums; but nowadays we have to put our figures in terms of billions, no longer in

terms of millions. The warfare of our time is on a stupendous scale and calls for stupendous expenditures.

Some of the items mentioned in this summary call for comment. Our loans to the allies are not always figured as expenses or charges. As I have just stated, they do not figure in our official statements of appropriations. And in a sense they are not expenditures of our own and call for no appropriations of our own. They are loans for which we get a *quid pro quo* in the form of promises to pay from the allied governments; and ultimately these obligations will be repaid. But for the time being the transactions mean a charge of our own, to be met from our own resources. During the continuance of the war and for such period after its close as we may still be extending aid to our allies, we must raise these sums by taxation or by loans and must face them as an immediate drain upon our present resources.

Another item which calls for comment is the revenue to be derived from the War Tax Act, expected to amount to two and one-half billions. Will it be just so much, or will it be more or less? On this topic we must speak with reserve. The amount which will be procured from some of the new tax levies is open to speculation; particularly as regards the one item which bulks largest in the act, namely, the excess profits tax. It remains to be seen what will be the final accruing revenue under this tax and under the others newly levied. But even a considerable margin of error due to such uncertainties will not seriously affect the general situation. The tax revenue under the act may amount to a few hundred millions more or a few hundred millions less than was anticipated. But as we know too well, a few hundred millions figure very little in these days; we frequently pay out sums of this amount over night in loans to our allies.

Whatever sort of calculation we make, one thing is clear, namely, that the revenue resources so far provided will not suffice for the presumable expenditures of the fiscal year 1917–1918. We have provided ten or eleven billions; we have appropriated nineteen billions. The expenditures may be somewhat greater than the appropriations, may be somewhat less; but it wolud seem to be certain that they will be greater than the revenue already provided. Before the fiscal year closes we shall have to consider further loans or further taxes. How far are we prepared to meet this impending

obligation? How far are we in a position to provide for so vast a drain upon our financial and economic resources? The prospect is one not to be faced with a light heart. And yet I think it is one which can be faced with a stout heart. We have undertaken an enormous task, but fortunately we have enormous resources, and perhaps, even more to our good fortune, we have a mechanism better adapted to the task than the country ever before has had in similar exigencies.

CIVIL WAR EXPERIENCE

Let us contrast the present situation for a moment with the emergency which confronted the nation in its last hour of supreme peril. The drain upon our resources during the Civil War is comparable to that which we must now face. Small as the millions of those days seem as compared with our billions, they loomed up large in the imagination of the men of fifty years ago and caused doubts and tremors such as are in evidence at the present time. Contrast now the situation at the outset of the Civil War and the experience of that time, with our own present prospects.

Without entering into anything in the nature even of a sketch of the earlier conditions, let me remind you of two striking episodes in the financial history of the Civil War. One was the dislocation, indeed the breakdown, of the country's banking machinery on the very first occasion of its use. The initial loan of the Civil War, the $150,000,000 of 6 per cent put out in 1861, was attempted to be marketed through advances from the banks of the North and through the eventual sale of these bonds on their part. It led within a few months to the suspension of specie payments by the banks; and the suspension of specie payments in those days meant suspension of all payments—virtual insolvency. Great as was the desire of the financial community, then as now, to come to the support of the government, the strain on the unorganized banks of those days was found to be too great at the very first trial. The banking machinery of the country proved quite unequal to lending adequate support to the government.

The second episode to which I will call your attention was the natural corollary from the first: the early resort to paper money and the early depreciation of the paper money. Inconvertible paper was issued at an early stage in the war, and to a greater

and greater extent as the war proceeded. How great was the disturbance of our monetary and industrial conditions because of the inflation of the war need not again be rehearsed. All students of the period know the evils which resulted for the community, and know too how vain was the effort of the government to meet its financial obligations by this means. Toward the close of the war it led to something like financial collapse, and the historian is tempted to speculate on the depths to which we might have fallen if it had been resorted to for a year or two longer.

On the other hand, taxation was resorted to slowly and hesitatingly and did not bring a really effective increase of revenue until the war was nearly over. It was not until the struggle had been going on nearly four years that, during the fiscal year 1864–1865, a great revenue was obtained by taxation. And the taxation of those days was almost exclusively indirect taxation, in the way of import duties and complicated excises, with unexpected and disturbing effects on the industries of the country at large.

PRESENT FACILITIES

Comparing now the unfortunate experiences of the past with the present situation and the present prospects, we find much that may lead us to take heart. We may not be prepared as adequately as we should be; but we are not entirely unprepared.

First of all, we have the federal reserve system. The government has at its disposal a great unified banking system which at once automatically utilizes the credit facilities of the country for the public service. Temporary loans can be arranged for over night. Certificates of indebtedness are taken and distributed with the minimum of strain. The flotation and distribution of the long-time securities are effectively aided by the same machinery. The financial community is no less patriotic than it was in 1861, but it is immensely better prepared to act as the Treasury's medium and to come to the Treasury's support. This advantage is nothing less than enormous. It removes the insidious temptation to resort to paper money, and saves the country the subsequent embarrassments and subsequent losses which such resort brought to us during the long period from the close of the Civil War to the resumption of specie payments in 1879, and which it will not fail to bring to the warring countries of the Continent which have been compelled to resort to the same demoralizing device.

I am not unaware that the utilization of our credit machinery by the government, and the extension of deposit credit which it will entail, may have the effect of inflation or something analogous to inflation. But inflation of this sort, in any case not easy to measure quantitatively and perhaps not susceptible of absolute proof, is at all events less dangerous for the future than the resort to fiat money. It is likely to correct itself automatically after the war. So long as specie payments are maintained, this sort of inflation cannot maintain itself permanently when conditions of peaceful commerce again have been restored. The unwelcome effects which it may have for the time being are in their nature transitory. If we maintain specie payments and refrain from resorting to paper money, we are spared such long continuing evils as came in the train of the Civil War issues.

But not only as regards our financial machinery and its utilization, but also as regards our tax system and its utilization are we in a state of preparedness. We have on hand, ready for immediate application, the machinery of the income tax. It is far from perfect; and yet it is immensely serviceable. If it had now to be set up *de novo*, we should have to wait at least a year, probably several years, before anything like the revenue now within our grasp could be obtained from it. It makes possible a resort at once to heavy levies without waiting for the slow process of getting the machinery of taxation in working order.

Moreover the machinery which is available for the administration of the income tax is serviceable also for that of the tax on excess profits. Separate returns are indeed to be called for in order to secure the collection of the latter, but the returns already made in previous years for the income tax will be available for purposes of comparison and correction, and the returns made for the income tax of the current year will be similarly of service. I would not minimize the perplexing problems which the Internal Revenue Bureau will have to solve in the administration of the excess profits tax. But it is no small alleviation that the income tax organization can be utilized without fundamental readjustment.

It is a good general maxim of taxation that *any* new levy should be initiated at a very moderate rate, and that the machinery of collection should be organized while the rate is still moderate. Of this perhaps no more striking illustration can be found than our

experience with the tax on distilled spirits. We are now levying that tax at the extraordinary rate of $3.20 per gallon. The attempt to collect a very much smaller tax during the early years of the internal revenue system led to evasion and fraud on a great scale. Gradually the system of collection and supervision has been perfected; and in consequence, a rate of tax which twenty years ago, even ten years ago, would have been deemed quite beyond the possibilities of effective collection, is now imposed with confidence. I would not for a moment pretend that our method of levying the income tax has yet approached a stage of highly perfected adjustment—such a stage as has been reached in Great Britain, for example, only after three-quarters of a century of experience. But the framework is on hand; it has been set up under low rates and therefore under conditions of little strain; it is in working order. We are suddenly increasing the rates of the income tax in such way that the revenue will be at least triple that of the last fiscal year, and six times that of the revenue of any preceding fiscal year. We should not have been able to expand this financial resource had we not already been prepared through the previous establishment of a reasonably effective system.

THE REASONS WHY WE ARE PREPARED

It may not be amiss to indicate briefly how we happen to be in a situation so much more promising than ever before in a similar exigency. Partly it may be a matter of great good fortune; but partly it is a matter of deliberate facing of possibilities, a deliberate setting of our house in order, for which our political leaders and the country at large may take some credit. Both parties are entitled to credit for the establishment of the federal reserve system. The preparatory work was done under the administration of President Taft, through the medium of the Monetary Commission then established which evolved the preliminary scheme. The system in its final form was definitively worked out and put into operation under the leadership of the present administration. The income tax again, though not established until 1913, was a foregone conclusion from long continued previous discussion and from the ratification of the constitutional amendment. As regards the immediate resort to heavy taxation, both through the income taxes and the long list of others that figure in the war tax act, something

is due to the preaching of the economists, who, though not perhaps in entire agreement on the precise extent to which resort should be made to taxation, have nevertheless been unanimous in urging immediate substantial levies. Not a little, again, is due to the example of our ally, Great Britain, who has not hesitated to grapple frankly with the financial task, to face the fact that war entails immense financial sacrifices, and to call upon the British community to submit at once to drastic taxation. And finally, not least, much is due to the courageous spirit of our own administration, our Secretary of the Treasury, the leaders of both parties in the House and Senate. Inevitably there have been differences of opinion as to the degree to which taxation should be resorted to, and as to the precise form of loans and credit arrangements. But there has been no hesitation with regard to the need of utilizing at once all the available machinery for procuring huge resources at the earliest opportunity.

OUR INDUSTRIAL AND ECONOMIC SITUATION

What can be said now of the economic and industrial situation as contrasted with the strictly financial problems? In the early days of the European War much was said and many calculations were presented about the total resources of the several nations, their total wealth, their total annual income. We were told that Great Britain, France and Germany had so many billions of wealth, and therefore so much which was potentially available for the conduct of the war. It requires no profound analysis to make it clear that figures of this sort signify little. The total resources of a country cannot be poured into the melting pot. Immense parts of them are by their nature unavailable. The land, the houses and buildings, a large part of the factories and workshops, are committed to uses from which they cannot be diverted to war service. I may remark, parenthetically, it is fortunate that this is the case. If it were not, absolutely everything might be poured into the public treasury under the spur of patriotic zeal, and the very last item of wealth and property might be engulfed in the fearful waste of war. The possibilities of eventual recovery are the greater because it is impossible in the nature of things to spend and destroy everything for the purposes of war.

The real problem for war expenditure is this: how much is

there of *free* resources, how much can now be carved out and made available for military purposes and in what ways can it be made available? Our calculations and speculations should be directed not to the extent of the people's total wealth or total resources, but to the extent of their free and divertible resources and income. This is another way of saying that our attention should be directed to the potential savings, the potential economies, the things that we can do without. How much income in terms of money, and in terms of labor resources and commodity resources purchasable with money, can be not only spared, but made immediately available and put at the disposal of the government during the war?

Here the question at once arises, what are in ordinary times the free resources of the community? What are its ordinary savings? On this subject we are unfortunately but ill-informed and can make nothing more than a guess. The usual or normal fresh savings and fresh investments of the people of the United States are supposed to be somewhere between three to five billions. I make no pretense of certifying to the accuracy of even this rough figure. But whatever be the sum we thus start with, clearly it is no more than suffices for a start. Even if we put at the disposal of the Treasury every cent that we ordinarily put by and save, we do not begin to meet the needs of the present time. We must do much more.

But all experience teaches that under stress of war we can do more, very much more. During the Civil War the North raised by internal loans vastly more than it had ever put into productive enterprise in the years preceding the war. It raised in addition vastly greater sums by taxation than the country had ever before dreamed of raising. I will not say that there are no limits to the sums which can be raised by a combination of loans and taxes, but it is certain that the ordinary savings and the apparent free resources of normal times give no clue to what can be secured under stress of need and under the impulse of patriotic zeal. It may seem now that we have undertaken a formidable task in our first and second liberty loans. So it seemed during the Civil War with that first loan of $150,000,000, which led, as I have already noted, to the breakdown of our banking machinery. The task seemed even more forbidding when in 1862 the United States resorted to the second great loan—what was then supposed to be the enormous issue of $500,000,000 of 5–20 bonds. So it has been in the European

countries, where successive loans have met successive response. The initial loans have seemed staggering, and yet successive loans have met successive response and the limit has receded as the stress of need became greater.

What is thus true of the potentialities of loans is true also of the potential tax resources. We have begun at the very outset on a considerable scale, with tax levies heavier than those made by this country in any corresponding stage in previous exigencies, heavier too than those made by any other country at a corresponding stage in the present great conflict. It is not only within the bounds of possibility, it is more than probable, that we shall have to resort to still heavier levies and to levies more widely distributed. Yet here, as with regard to our borrowing capacity, we never know how much we can do until we know what we have to do. Our loans and our taxes already mean that we must begin to restrict and curtail, must learn to dispense with luxuries and comforts, perhaps with some things which we have regarded as necessaries. We shall have to proceed further in the same direction. Every community must adjust its industries and its expenditures to the needs of a war through a gradual process. We have entered only on the first stage.

SOURCES YET UNUTILIZED

One last aspect of the case I would bring to your attention. How far are there resources which as yet we have not tapped? How far are there spare fractions of income not ordinarily reached either by any process of direct taxation or by any process of habitual saving and investment? In this country we have a great mass of prosperous workers who ordinarily spend the whole or almost the whole of their incomes, and who yet are in a position both to bear burdens of taxation and to make some savings from income. There are millions of skilled artisans, salaried men and women, well-to-do farmers, who go their way with ease in ordinary times, and whom the ordinary machinery of taxation and finance does not touch. It is not desirable to apply to this large stratum of the community any burdensome direct taxation of incomes. True, some direct levy on them is made through the present remodelling of our income tax; the limit of exemption, formerly $3,000 to $4,000 a year, has now been reduced to $1,000 to $2,000. But the rate of tax upon the lowest incomes now brought within the purview of the

tax is left very moderate, and this application of the income tax is rather a response to a question of principle than a probable means of attaining a substantial increase of revenue. Consumption taxes again, in the way of import duties and excises, doubtless can bring in something substantial; yet there has been a proper hesitation from resort to them at high rates.

On the other hand, the voluntary handing over of substantial parts of these incomes to the government through the broad distribution of public loans is feasible upon a much larger scale than has before been supposed. It offers in many respects great advantages. The small bond buyer is in the aggregate an important personage. And when he is reached by adequate facilities and proper propaganda, he will respond generously and quickly. At the same time the wide distribution of public loans is the most effective antidote to those consequences of public debts which have caused them to be most strongly opposed. A great public debt means the permanent maintenance of taxation for the purpose of meeting interest upon it, and so the permanent diversion of income from the great mass of the taxpayers to the smaller number of the holders of public securities. If however, the number of these holders be not small, but in the aggregate large; if the distribution of public loans be not solely among the rich and well-to-do, but widely dispersed through every class of the community, then some of the most undesirable features of the resort to loans, if not entirely obviated, will be much mitigated.

In this respect we may learn something from the enemy. The Germans have cultivated to a high degree the stimulation and collection of loan subscriptions from persons of moderate and small means. A rough summing up of the operations under their first five loans indicates that out of a total of something like forty-seven billions of marks (or eleven billions of dollars) about three-fifths have been in subscriptions of ten thousand marks or less. No doubt there are possibilities of manipulation in these figures. We must be on our guard against all official statements that come from that quarter. But there is no reason to question that subscriptions of moderate and small amounts have been heavy. It is gratifying that our own financial leaders are awake to the importance of reaching the small investors and are diffusing our loans as widely as possible. Of the total subscriptions to the first liberty loan, roughly three billions of dollars, one and one-fourth billions were

in amounts of less than ten thousand dollars and received in full their allotment out of the two billions of bonds finally issued, or the same proportion as that just noted for the German loans.

Our conclusion is that we may look forward to the future not indeed with a light heart, but with courage. We have assumed enormous responsibilities. We have not yet sufficiently provided for meeting even those of the present fiscal year. But we have taken great forward steps. We are ready to proceed further; and we may face coming events, not without anxiety, nor without a realization of what the contest means, but with a firm resolve to use our strength and our resources to the utmost, and with a firm confidence that the country will provide the means for the utmost military and naval strength.

THE TASK OF FINANCING THE WAR

By John J. Fitzgerald,

Chairman, Committee on Appropriations, House of Representatives, Washington, D. C.

At the outbreak of the war there was keen speculation as to its duration. Since the Russo-Japanese War it had been the belief of many eminent military experts that all future wars would be short and decisive. That opinion was predicated upon two important assumptions; one, that modern methods of warfare had been developed along such a plane of destruction that, if hostilities were conducted on an extensive scale, the harvest would be so dreadful as quickly to compel peace; the other, that the financing of military operations upon a gigantic scale was so dependent upon certain definitely fixed money centers, that financiers, rather than military genius, would wield the more potent influence in determining the final results in conflicts between nations.

The difficulties in the Balkan States prior to the present war strengthened those who believed that modern wars must necessarily be short. It is extremely doubtful whether any responsible statesman in any of the countries now engaged in the controversy had the slightest notion in the early days of the war that a war in which were involved practically all of the great civilized powers, or even a relatively small number of the more powerful ones, could endure for any considerable time.

Both of the assumptions have been proved to be unfounded. The wastage in the war, as well as the property loss, and the expenditures necessary to sustain the military operations undertaken have been of such magnitude as to stagger the imagination. The wildest estimates of the most extreme militarists during the period immediately preceding the war have shrunken into insignificance, and no man is sufficiently wise to venture a prediction as to the duration of the hostilities that is of any value in arriving at the correct solutions of many exceedingly important problems pressing for consideration.

Lord Kitchener's announcement shortly after the outbreak of the war that preparations should be made for a three years' conflict

was a rude shock to the civilized world. Received quite generally at first with amused incredulity, it speedily was accepted as an unfortunate reality. The importance of time in the problems to be determined cannot be overestimated. For it is the probable duration of hostilities upon which hinges every question concerning the use of both personnel and material, the conservation of the nations' energies, and the marshaling of the available and of the potential resources of the war afflicted countries.

In at least one very important respect the United States are fortunate. As the war had been waging almost three years before they became embroiled, they have the benefit of the experiences of the other belligerents to profit by, and many grievous and expensive errors that otherwise would probably be unavoidable should not now be made.

If the duration of the war could be definitely fixed or accurately predicted, its financing would be a simple problem in elementary mathematics. If the war were to be sufficiently brief and the expenditures upon any sort of a reasonable scale it would be possible for the United States to imitate the example of Mr. Gladstone in the Crimean War and defray the cost from the current revenues. But there is no such simple problem for the United States. Although war was declared on April 6, 1917, the expenditures up to June 30, 1918, will practically be within a year, which makes the usual, convenient and ordinary basis for comparison.

The appropriations by Congress available till June 30 next aggregate $18,879,177,014.96. There is included in this sum $7,000,000,000 to be loaned to the allies of the United States. In addition to the specific appropriations, authority has been given to enter into contract obligations to the extent of $2,511,553,925.50. Obligations to that extent may be incurred and may mature during this fiscal year, which ends on June 30. If certain manufacturing processes can be carried on more rapidly than contemplated the authorized obligations will be converted into cash payment demands and the expenditures will be measured by the gross total of $21,399,730,940.46 the sum of the appropriations and contract authorizations.

There have been some intimations that the appropriations were made by the Congress in a blind, uninformed, haphazard manner. I cannot speak for the Senate of the United States, but I am quali-

fied to speak authoritatively for the House of Representatives. Of the $14,399,730,940.46, which is the total of the appropriations and contract authorizations less the $7,000,000,000 to be loaned to other belligerents, approximately $12,000,000,000 were provided in bills prepared under my personal direction, and which were in my charge during their consideration and enactment. With an experience of thirteen years as a member of the Committee on Appropriations, during seven of which I have been its chairman, I am able to state that in my experience no bills were more thoroughly, carefully and intelligently prepared than the bills which made available the vast sums mentioned. More than $840,000,000 requested by the administration was refused either because the purposes for which the expenditures proposed were not imperatively essential for the conduct of the war, or because it was determined that in many instances progress in preparation could not keep pace with official aspirations, and as the money probably could not be expended in the fiscal year it was not appropriated.

So far the judgment of my colleagues and myself has been justified by events. It is quite possible, however, that men may be mobilized, the equipment manufactured, ships constructed and armies trained and transported and enabled to participate in actual hostilities much more quickly than the Congress believed in providing funds for this year's expenditures. Should that be so, then additional appropriations must be made at the coming session to be available during the current fiscal year.

During the recent session of Congress I had occasion to point out that since the outbreak of the war until August first of this year Great Britain had expended $21,385,000,000, which sum included $4,500,000,000 advanced to her allies. Including $750,000,000 expended by India and the overseas dominions, Great Britain's expenditure during the three years of the war, excluding advances to her allies, aggregate $18,500,000,000.

During the same period France expended $15,327,400,000; Russia's burden, which is more of an approximation than any other, was $15,000,000,000; Italy, during the period of her participation in the war has expended $3,120,000,000; making a total expenditure by the Entente Allies of $51,947,400,000.

Germany, including advances to Turkey and Bulgaria, was estimated to have expended $21,300,000,000, and Austria-Hungary $12,800,000,000, or a total of $34,100,000,000.

Including loans the United States in the first year proposes to expend as much as Great Britain, more than France, more than Russia, probably as much as Germany, and one-third more than Austria-Hungary has expended during the entire three years of the war; 23 per cent of the total of all the nations in the war, and 65 per cent as much as Germany and Austria-Hungary during the same period. Even if the amount of the loans to our allies be excluded the figures are still sufficiently startling; and yet as the money to make advances to our allies must be obtained either through loans or taxes the authorized loans cannot be eliminated from consideration.

It must be remembered, too, that these vast expenditures do not make provision for a very extensive military organization contrasted with the numbers that other belligerents have called to the colors. If the United States be compelled to mobilize to the extreme its military resources the figures now under consideration will be dwarfed by comparison with those that will follow.

From a careful study of the purposes for which available funds are to be applied, considering eliminations and probably substitutions, there is no prospect that expenditures will lessen if the war is to continue. They inevitably will increase and be very much greater than during the present year.

The estimated annual revenues of the government from all sources are $4,033,500,000. The proposed expenditure this year approximates $20,000,000,000. Upon that basis it is proposed to meet 20 per cent of our expenditures from taxation and 80 per cent from the proceeds of loans. If there be excluded one billion dollars from the estimated expenditures and the same sum from the estimated revenues to represent the normal cost of maintaining the government, it appears that the cost of the war is to be defrayed to the extent of 14 per cent from taxes and 86 per cent from loans.

If all of the other lessons of history are to be ignored the United States at least should not be indifferent to the disastrous consequences that followed the attempt to finance the Civil War by resorting almost exclusively to loans. A grossly inflated national debt, without the proper exercise of the taxing power, inevitably results in an impaired national credit, an increased interest rate and a depreciated currency.

The task that the United States have assumed in this war is so unique, of such magnitude and so fraught with difficulty and peril

as to compel resort to means that seldom would be required. It is proposed to raise and equip armies numbering in the millions, to construct ships for their transportation to engage in battle three thousand miles away, through seas infested with a hitherto unknown peril. It is proposed to produce food and munitions not only for our own enormous population, but largely for Great Britain, France, Russia, Italy and many small states. The task will be no easy one; it will tax to the extreme our power and our resources. In all preparations in every other direction the plans have been made on a comprehensive scale and with a wise vision that events will justify. Our financial plans are not developed to the extent they should be.

It is the boast of financiers, statesmen and economists of Great Britain that the empire's credit is as sound today as at the outbreak of the war. They assert that the liberal manner in which the taxing power has been used to obtain necessary revenues is wholly responsible for that situation. The wealth of the United States is estimated at $250,000,000,000; Great Britain's at $80,000,000,000. With expenditures on account of the war approximately the same Great Britain is obtaining from taxation at least 25 per cent more than the United States, although her wealth is approximately but one-third of ours.

I am not of those who believe that a proper fiscal policy would justify attempting to obtain all the revenues required from taxation. It is doubtful whether any group of public men advocate such a policy. The predominant inclination is to rely chiefly upon loans and my belief is that public men in the United States are too strongly inclined to place the burden upon posterity by resorting to loans.

The true and only justifiable policy is to utilize the taxing power to the fullest extent and to resort to loans for the deficit in revenue. There is no possibility that an undue proportion of the burden will be placed upon revenues. Our preparations have been initiated upon the only safe theory—that the United States has become a participant in a war of extraordinary magnitude that will be of unusual duration. Our fiscal policy must fit that theory.

While resort cannot be had to many sources of revenue for sound economic reasons, while some will not be because of political expediency, there still remain many untouched sources, and heavier levies can be made upon present ones without imposing burdens that cannot be justified.

For instance many believe that with the recent revenue law the limit has been reached in the impositions that may be placed on incomes and excess profits. I am not in accord with that opinion. If the war is prolonged over many years, as it is quite probable, as we have not nearly exhausted our ability to obtain revenue through taxation, it is the part of wisdom to increase quickly our revenues. Four billion dollars annually does not begin to measure the possible revenues of the United States.

During the consideration of the recent revenue bill I made some studies which were to have been utilized in a discussion of this question. The burdens resulting from the preparation of the appropriation bills precluded my participation. An examination of the earnings of 140 of the leading industrial concerns over a period of years furnished much material for reflection. The list was prepared carefully so as to include only concerns believed to have been upon a sound financial basis. Their earnings in 1914 aggregated $250,000,000, in 1916, $1,250,000,000.

One fact should be emphasized so forcibly at this time that the American people should not be capable of misunderstanding. It should be proclaimed broadly that neither the individual nor any group was entitled to inordinate profits from the necessities of the government, nor would they be permitted.

I speak not as an enemy of wealth nor as one hostile to successful industry or to proper rewards for the exercise of that peculiar genius essential for the conduct of exceptional enterprise. The future of our people, as well as the fate of civilization and the continuance of democratic institutions, hinges upon the outcome of this war. Individual ambitions, interests or prospects must disappear before the greater objective—the welfare of the nation. No system of taxation can be devised that will apply with exact equality to every individual; the necessities of the government cannot be supplied without business disturbances that will work cruel hardships in some directions. No one can predict in what direction he will be asked to make sacrifice or assume an exceptional burden in the onward progress of the nation to its ultimate end. Many will be called upon for the supreme sacrifice of their lives, none will be tolerated whose grievance rests in the contention that their material prosperity has been arrested or affected in the necessary marshaling of the country's energies.

It is not my purpose to attempt to detail the sources which may still be tapped for additional revenues. This is not the occasion for me to do so. The pressing need at this time is to bring home convincingly to the masses that they must be prepared to endure much greater burdens from taxation. The country must be persuaded to change its extravagant and wasteful habits and to cultivate thrift. During such a crisis the people should not expect to spend as lavishly nor to indulge luxurious tastes as freely as in days of peaceful prosperity. The nation must be awakened as never before in its history; the people must be taken fully into the confidence of the government; they must have presented again and again the real picture of world conditions so that every individual shall appreciate and discharge his obligations in full.

Even if there were not other sound and imperative economic reasons, that effective method of reaching the public conscience would justify resort to extraordinary methods of taxation at this time. No system should be tolerated that will paralyze industry or breed discontent; none should be avoided essential to provide the revenues inperatively required and that will distribute the resulting burdens as equitable as experience and knowledge dictate.

REACHING THE INDIVIDUAL INVESTOR

By Albert W. Atwood,
Princeton, New Jersey.

This paper will be confined to a very limited and specific, although I hope not wholly unimportant, phase of the problem. It is a stupendous subject, and the success of war financing depends on a large number of national and economic questions and policies; upon a sane ratio between taxes and bonds; upon a sane equilibrium between doing away with extravagance and waste on the one hand, and business prosperity on the other; upon an alert observance of what European countries have done; and the finding ultimately, if the war keeps on, of a method, if such a thing is possible, of converting into the basis of credit for war loans, securities owned by our savings banks and insurance companies. That is the most serious problem of all, and one whose solution has not yet been seriously attempted.

The subject of this paper is the specific and limited one of reaching the individual investor in war loans—war bonds. What has happened? President Wilson decided on war; Congress decided on war. Mr. McAdoo and Congress then had to raise the money and they put through a bill; so many bonds, so much taxes. Mr. McAdoo called in the governors of the twelve federal reserve banks and said, "Raise the bonds." That is what it amounts to.

The governors of the twelve federal reserve banks each appointed a committee, and in the larger cities—New York and probably Philadelphia, Boston and Chicago—the committees are made up of men of such prominence and of such wide activities that they cannot devote much time to it; and it comes down to this, that in each large federal reserve center, two or three men, unknown to the public but well known in their particular lines—experts—are given the problem of selling in four weeks, billions of dollars in bonds. In New York City two men practically had to sell two billion dollars worth of bonds in four weeks.

Now let us put ourselves in their places. For lack of time, I am not going to consider at all the question of institutions, that is, of

corporations and their large subscriptions, but just the individual investor. There are three immediate methods of organization for reaching the individual investor: first, community; second, occupational or vocational; and third, one which has been little attempted as yet, *viz.*, his position in the capitalistic scale, in the vernacular, according to how much money he has. That has been attempted only to a slight extent.

In the cities the community organization has been wonderful, but not so, as a general rule, either in the country or in the smaller places. This is natural enough. The city is impersonal, but not so with the small place. Now, I want to pay a tribute to the devoted work of the liberty loan committees in the small places. In my own town, halfway between New York and Philadelphia, the chairman of the committee was a very fine young man who did splendid work, and there are thousands of others like him. But these small town liberty loan committees must wake up and must handle this problem without kid gloves. If they want to raise loans—and they must if this war continues—they have to face the naked problem. They are afraid to go after the subscribers. That is their trouble. Everybody knows everybody else in a small town of five or six thousand population, or in a suburb, and they are afraid to go to them.

And what happens? The rich people subscribe, and the wage-earners, if there happens to be a factory there with an employer to persuade them or to bring pressure; but the people of moderately comfortable circumstances are not doing their duty, and it is because the bankers and the liberty loan committees are afraid to go after them.

I personally know of a family living on a scale of great luxury that gave it out that they might subscribe for $200 worth of bonds, but no more. Perhaps they took more and perhaps they took none at all, but there was no method of checking them up. There are numberless instances of plain holding back, of fundamental, individual selfishness.

The occupational organization is splendid in the cities where committees can be organized, but it doesn't work in the small towns at all; and furthermore, no one has yet organized the occupational campaign to reach a class of people, perhaps not great numerically, but of wealthy circumstances. I refer to the independent business

man, the operator, the speculator, the trader and other similar individuals. There is no way of reaching them. There is no way of reaching men of my profession. No one has ever solicited me to buy a liberty bond, except one boy scout.

And most important of all, there seems to be no way of reaching the retired person of just moderate circumstances, and the woman of moderate circumstances—the widows and old maids who have inherited fifty or seventy-five thousand dollars. They are not reached. Some of them are patriotic and have come forward of their own accord, but the occupational program does not get to them, and in the small place the community program does not reach them.

This matter of reaching people according to the amount of money they have is perhaps another phase of the point I have just been making, and I can get at that best by referring to a very specific thing, and that is the matter of quota. For each town a certain figure is presented and the people are told, "You must subscribe a certain amount of bonds." I don't know whether politics has entered into that or not—I rather think it has—at least community politics. For instance, a large city will say to a small town nearby, "You raise such and such an amount," and sometimes they will tell them to raise more than they ought to. That is not the important thing. Perhaps I am open to correction, but I think that these quotas are determined on the basis of bank resources and to some extent, I think—in the second liberty loan, at least—of population.

Now, that may be the only practical basis. It is very foolish for me to criticize a thing that other people know very much more about, but if this war goes on it will be necessary to have a committee of experts, of economists, to try to get at this thing on the basis of wealth and make these quotas on the basis of wealth, as well as on the basis of banking resources.

Take the little town of Kerhonkson in New York state. It exceeded its quota many times and there was an item in the papers about it. Yes, it exceeded its quota many times because there are no banks in the town while there is a large sanitorium patronized by millionaires. The owner of the sanitorium is wealthy and is very loyal and he probably put in a big subscription himself. There is no particular credit to the town in that, and they would not have

had the apparent results they did if their quota had been on the basis of actual wealth instead of banking resources.

It may be necessary in the small places to resort to publicity. Of course, everyone is opposed to that, but I honestly believe that if the war goes on, we must, at least in the smaller places, post up a list of those who have subscribed, and if that is once done there will be no lack of subscriptions.

Now these are details, but they are important ones. Some captain of industry has said that we might have to raise a hundred billion dollars if this war continues, and it reminds me of a dream I had the other night. I was approaching a solid stone wall that couldn't be scaled, but as I came up to it, it faded away and I walked right through.

It is not as easy as that. Professor Taussig has said that we must not approach it with a light heart; but three years ago our most eminent bankers said that if we loaned more than one billion dollars to our allies, we would drain our country of its resources. We have already loaned them some five billions, and we have bought back three billions of our own securities, and we are raising a large sum of our own. That shows how these problems change as we approach them.

I have lately been making for an entirely different purpose, a close analysis of what may seem to be an uninteresting subject—the personnel as shown in the directory of the New York Stock Exchange. It is a very great revelation, although I have made very similar analyses before. If you will go through that directory you will find there a machinery, for the most part, unknown to the world for investment of surplus wealth, that is perfectly marvelous. I don't refer to what we ordinarily call the bond or brokerage business, but to the fact that this country is approaching, as England has long ago done, the position of being a possessor of great accumulated wealth, and that one broker after another is really nothing but a family investment agent. That is what it amounts to. There are railroad magnates, bankers, steel kings, copper kings, and so on indefinitely. Hundreds of firms in the New York Stock Exchange are nothing but channels for the investment of accumulated wealth, and I do not think we realize how much there is of that in this country.

BORROWING AS A PHASE OF WAR FINANCIERING

By Henry C. Adams,
University of Michigan.

Since the United States became an active belligerent many opinions have been expressed relative to the financial management of this war. I have tried to analyze these opinions in order to discover, if possible, the economic basis on which they rest. I have also followed the debates in Congress on finance bills, and have read the utterances of the Secretary of the Treasury, who, by virtue of his official position, ought to be the leader in financial opinion and the formulator of a comprehensive financial program. While the legislative outcome of all this writing and speaking does, on the whole, command a qualified approval, it fails, as it seems to me, to grasp the significance of the industrial side of war financiering. It is exclusively to this phase of the subject that I ask your attention.

Public and Private Credit Compared

My first remark is not so much critical as it is the expression of a neglected truism. Much of the gratuitous advice given to Congress rests on the implication that the rules of credit evolved from the study of ordinary business experience can be carried over and applied without modification to government borrowing in time of war. This, of course, is not true. Capital borrowed for commercial investment is a step in capital building; capital borrowed for war uses is a step in capital annihilation. The former adds a new source from which the fund of free capital may be filled; the latter not only prevents the opening of new sources, but it tends to dry up some of the sources from which free capital now flows. Any program for the financial management of a war that fails to recognize, and to act on, this truth, is bound to meet misfortune.

Again, in the case of private borrowing, it is the continued prosperity of a particular business that validates the underlying securities; in the case of public borrowing, it is the continued prosperity of all industries, regarded as a production unit, that

gives worth to government bonds. From this, also, the war financier may read a lesson.

But perhaps the most significant difference between the use of credit for investment and for war is found in the principle upon which reliance must be placed for the control of each. The commercial investment of capital is controlled by the expectation of personal profit and, consequently, all of the well established laws of business conduct may be used as tests for such an investment. This control and this test are absent when a government borrows money to meet the cost of war. It means the adjustment of credit contracts with a view to their ultimate results as well as their immediate success. This means the possibility, if not indeed the necessity, of a radical interference with the orderly procedure of an established market for capital. The selection of a rate of interest on a government bond, for example, does not so much depend on the ability of the government to sell its bonds, as it does on the industrial effect of the sale of bonds at the rate selected. The experience of an industrial promoter who holds in mind the making of a profit by a particular enterprise, is of slight importance for the solution of the task of carrying through the finances of a great war. A new set of industrial purposes and new conditions for the use of the machinery of credits are brought to the surface by the advent of a war. This is the first thought to which I desire to give expression.

The Nature of the War Burden

It is equally necessary to understand correctly the content of the war burden. This is not, as many seem to reason, the sense of deprivation that comes with the payment of money, whether the occasion of that payment is to fill a loan or to cover a tax. There is doubtless a psychological side to war financiering. A successful treasury policy must make proper use of the motives by which men are controlled when they deal in business affairs. But this does not mean that the industrial burden of a war is a mental state, or that the chief element in that burden can be spread over a period of time by the manipulation of credit instruments.

The burden of a war, correctly apprehended, consists in the use of the productive power of the country for unproductive consumption. When a nation declares war, it has turned its face towards

commercial bankruptcy. Its position is altogether like that of a railway that continues to operate even though it fails to maintain its property out of current revenues. This, of course, means, in the case of the railway, that the management borrows from its property; that capital is depleted to cover operating expenses; and it is only a question of time before such a practice will carry the property into the hands of a receiver.

This is equally true of the industry of the nation regarded as a collective business unit and from this statement one may read the task of the financier in time of war. It is for him to so control both the machinery of credit and the machinery of taxation that the productive power of the country may be used to make headway against unproductive consumption, and at the same time to hold under control those forces that tend to wreck the industrial organization by which that power is maintained. This is the gist of the problem of war financiering and every act of government, whether within the Treasury or without, that fails to test its merits by this rule is likely to prove to be an embarrassment to sound financiering.

This point of view is familiar to all students of finance but somehow it always needs to be "hammered in" when the occasion for a war program arrives. For that reason, I venture to try to express it in another way. The claim for production in time of war need be no greater than that claim in time of peace. The demands of government are doubtless increased and there is also an embarrassing change in the kind of things demanded; but this demand, if considerable, must result in the curtailment of ordinary peace demands. This means that the task of carrying through a great war involves a radical readjustment of established industries. It is the cost of this transition that constitutes the great, the acute, the immediate burden of the war—a burden none the less real because it is unrecorded on the books of the Treasury. This transition ought to be attained at the earliest possible moment, so that balance in market conditions may be restored and maintained notwithstanding the change in the character of current consumption. To assist in this transition, if not indeed to place it under guidance and control, is a peculiar service of credit financiering; and it is the recognition of this responsibility that ought to give a definite industrial purpose to public borrowing during the first and second

years of a great war. This, and this alone, will enable the financier to lay the foundation of a trustworthy program of treasury administration.

THE BEARING OF INDUSTRIAL CONDITIONS

Since the task of financing a war centers in the control of industrial conditions, the industrial situation at the outbreak of hostilities is of great significance. This remark applied to the business situation of last spring calls for three observations.

First. The foreign market for capital was closed. The United States had for two years been loaning work to Europe. England, France and Russia were still in the American market with large orders for war munitions and their inability to pay for goods received had so affected foreign exchanges that settlement with American capital became a necessity. Under such conditions the classical argument in favor of a loan policy at the outbreak of a war was no longer applicable. It was not possible for this country, last spring, to relieve the first stress on home industries by calling to its aid the workshops of foreign countries. It was not possible to wait, as might have been done if bonds could have been sold in the foreign market, for the law of supply and demand, working through an inflated market, to effect the necessary readjustments in industry. This, so far as I know, is a new situation in war financiering. Since the world became familiar with international credits, there never has been a war that involved practically all of the capital-building nations of the world.

The lesson to be read from this situation is not far to seek. The United States must rely on its own capital and on its own labor for carrying through this war; and the quicker this capital and labor are organized to produce what the war needs, the earlier will the industrial phase of the nation's finances be brought under control.

Second. The second fact in the present situation I do not profess to understand. Not only is the door closed to foreign borrowing, but the financial center of the world has been transferred to New York. This, at least, is said to be the case. It is referred to by responsible writers as a fact of great significance and as an element of strength in the financial situation of this country. This may perhaps be true, but it looks to me like an increased demand for American capital in addition to our current industrial and war

demands. It may mean, however, the flow of neutral capital to New York and possibly of selling United States bonds in the Orient, in South America and in the neutral countries of Europe. But I confess that I do not understand what this transfer of the financial center of the world to New York may mean, and let it pass as an important fact that should be analyzed and mastered by those who are responsible for the financial program on which this war is to be fought out.

Third. A third fact of importance in the industrial situation is that the outbreak of hostilities found this country in a condition of inflated and one-sided prosperity. Had the formulation of a financial program taken place in 1913, when business was relatively slack, the task of the financier would have been somewhat easier. Under such conditions reasonable taxation would have acted as a stimulant, and the expansion of government demands would have been regarded as industrial encouragement. It would have been possible, by a judicious use of public credit at normal rates of interest, to have assisted, if not to have forced, the beginning of an industrial transition from a condition of peace to a condition of war.

The practical suggestion that springs from the fact that in April last this country was in a condition of unhealthy prosperity pertains to the rate of interest that the first public loans should have borne. Of course, we who are on the outside do not know all of the considerations that led the administration to issue its first loan at $3\frac{1}{2}$ per cent and its second loan at 4 per cent. These considerations may have been non-financial in character; but, if a quick change in the industrial machinery of production is accepted as the prime test of a sound financial program for the first year of belligerent conditions, there is reason to believe that this result is retarded rather than hastened by an issue of public bonds at a rate of interest below the normal market rate. It is, however, of slight use to discuss this phase of the problem. The two liberty loans are accomplished facts. They are a new factor to be considered in the further financial conduct of this war. The manner of their industrial working is at present highly speculative. It is possible that the movement in capital resulting from them is along channels that will help rather than hinder the reorganization of the workers of this country on a war footing. Of the enthusiasm which they aroused there can be no question, and this fact at least is the

occasion for encouragement. But the making of a program adequate to meet the demands which this war is likely to impose is a task as yet unaccomplished.

A Suggestion

There is nothing new in the principles of the science of finance, but the application of these principles to ever changing conditions sometimes justifies the consideration of new expedients. It is from this point of view that I desire to say a word.

There are three facts respecting the conditions under which this war is being fought that impose unusual responsibilities on the administration. The first is the dependence of the allies on the United States for an adequate food supply; the second is the development of a sense of social justice which forbids the government to make use of market inflation for carrying through a drastic financial program; and the third is the remarkable growth of class interest as exemplified in the constant demands for increased wages.

The situation created by these three facts is serious. They make the task of financing this war a difficult one. Thus far, the administration has endeavored to meet these responsibilities by establishing an organization for food control; by attempting to control the minimum price and to execute contracts on the basis of analyzed costs; and by accepting the financial liability for the payment of wages in order to keep industries going. These attempts, also, like the issue of the liberty loans, must be regarded as elements in the present situation, so quickly do ideas crystallize into conditions. The suggestion which I wish to make is that this effort on the part of the government to control the food situation, to adjust prices for munitions of war, and to pay wages which will keep the wheels of industry turning, cannot be carried on successfully each independently of the other; nor can any of them be accomplished unless they are made to correlate with the issue of bonds and the collection of taxes in a comprehensive, consistent and adequate treasury policy. These tasks are, from their nature and because of their industrial significance, a part of the task of financing a war.

It is possible to make this suggestion a little more concrete. Consider, for example, the problem of food supply. Nothing will be

accomplished by the declaration of a minimum price, or by an attempt on the part of the federal government to out-speculate the speculators. If anything effective is to be accomplished along this line it is essential that the ordinary considerations of commercial profits should be brought into play under the direction of a public purpose. Last spring a special effort was made to induce farmers to raise potatoes. The farmers of Michigan expressed themselves as willing to plant potatoes provided they were guaranteed a normal profit on the planting. They asked the guarantee of a maximum price or of a price adjusted to an analysis of cost. This the government was unwilling to do. According to the premise laid down in this paper the government should have guaranteed the price and have covered the guarantee by an issue to the individual farmer, in case of accruing liability, of a 5 per cent bond. Assuming this to have been done, not only in the case of planting potatoes but in every other crop the production of which in adequate amounts is essential for carrying on this war, and assuming that the direction of agricultural planting had been sought under the guidance of the administration, not only would the bonds have been placed where, from the political point of view, they would do the most good, but the industrial problem, so far as war financiering is concerned, would have been solved for the industry of agriculture. Suggestions for the administration of such a project may be found in the way France manages her tobacco monopoly.

The same procedure could be followed with factories that furnish the government with war supplies. A certain portion of the amount that the government must engage to pay (perhaps an abnormal profit, who can tell?) could be covered by government bonds. This suggestion is especially pertinent in the case of the building of new factories to meet the new war demands. In such cases, the uncertain element is the depreciation in the value of the investment when the war draws to a close. It is the fear of this loss that retards the outswing of new investments for producing what the government needs. Eight per cent current profit, with the possible loss of a 100 per cent depreciation in two years due to obsolescence, is not an attractive outlook. It is a reasonable proposition, in order to encourage the investment of private capital in war production, for the government to promise to reimburse investors for such loss of capital as they may sustain, and the easiest

way of covering this loss is by the issue of bonds to factory owners equal to the depreciation of obsolescence. By this means, the immediate necessity of ready money collected through taxes would be reduced; and this, as every student of finance knows, is the only justification of the use of public credit.

The suggestion here submitted might be used, also with good advantage, in the treatment of wage adjustments. If the government must guarantee wages in order to keep industries going, it would be highly advantageous for such guarantee to be covered by the use of public credit. The idea of partnership between the government and certain industries during the continuance of the war, would, by this expedient, be extended to the great body of industrial workmen. The difficulties, as well as the advantages of this plan, lie entirely on the surface, and for this reason I do not venture at this time to consider the details of the suggestion.

FINANCING WITH WAR SAVINGS CERTIFICATES

By Frank A. Vanderlip,
President, National City Bank, New York City.

The first factor in a financial problem, whether that problem has to be answered by a corporate manager or a minister of finance, is its size, and one of the most remarkable things about the present problem of borrowing by the government is that the size of the problem is utterly unknown. No one can tell within billions of dollars what the demand will be upon the treasury in the eight months that are left of this fiscal year.

Billions of dollars is a new phrase. Our whole debt was but a billion dollars when this war broke out. Few of us, if any, understand what a billion dollars is. When Congress got to appropriating in amounts reckoned by many billion dollars, I think that Congress itself almost lost track of what it meant. Appropriations, indeed, were so large that they were much misstated at the close of Congress. There was an official statement that the appropriations of this Congress had reached twenty-one billion, three hundred million. That amount was an error. The exact figures are not yet made up, but I was told at the Treasury recently that the present estimate is nineteen billion dollars, the former estimate having had some duplications.

Appropriating money has usually meant spending money. That does not necessarily follow when you get into sums approximating twenty billion dollars. Not only are we just learning the amount of the appropriations, but no one can tell within several billion dollars of how much of those appropriations will be used.

When war broke out we were as completely unprepared as it was possible for a nation of this size to be. We started to prepare, to prepare in every way, to prepare for a long war. Men charged with the responsibility of preparing this thing or that went at it with energy, with enthusiasm, with a patriotic desire that the thing that they were responsible for should be fully prepared at as early a date as possible. The result of that has been that we have a situation in

which no perspective has been put upon the problem. Emphasis has been placed everywhere.

It follows that these huge sums asked for from Congress were patriotically granted by Congress—Congress could do little else. There is no use of fault finding with the amount of this total. There is no just ground for criticism, but it is a total so huge that it is almost beyond comprehension, and a total so uncertain when it comes to the actual demand for credit from the Treasury that the Secretary of the Treasury is facing a situation in which he cannot calculate, as I have said, by billions of dollars what the total demand upon him will be.

Now money does not fight a war. We can appropriate money. We can provide credit but that does not accomplish the result. It is current effort, it is man power, it is industrial capacity, it is goods and services. So no matter what we appropriate, no matter what the Treasury provides, the sum that will be spent will be measured by the goods and services that can be bought.

In my own opinion—and this is in no sense an official opinion or one representing the government—I do not believe that the total expenditures can reach by a very long mark the total appropriations. It is true that contracts have been made or are in process of being made, that will absorb, let us say, the total nineteen billion dollars, but no man can say when the goods that are being contracted for will be delivered. We are putting a pressure upon the industrial capacity of the country that is undoubtedly greater than it can meet. Up to the present time there has been no directing mind over this problem saying what is most necessary, what is absolutely essential and what can be deferred, measuring the industrial capacity of the people to see how the demand should be applied to our total industrial resources.

That is going to be necessary if we bring efficiency and democracy into harmony. At present there may be as great activity put upon providing proving grounds for a gun that will not be built in two years as there is in providing something that should be going into the next ship; and the ship will be the controlling factor of what we are able to do.

It does no good to call men from the draft, to build expensive camps for them, to provide them with arms, if we cannot transport them, if we cannot feed them in the field, if we cannot provide the

things that are necessary to an army. It is this necessity for perspective on the situation that is the most needed thing that I see in Washington and the thing that will determine what the financial problem of the government is to be.

But let us suppose that it is to be nineteen billion dollars within the fiscal year—and the figures would seem to indicate that that is it. The different departments declare that they can spend the amount of the appropriations up to that total. I doubt myself if they can, but that is the belief of the people who are responsible for the expenditure. With that statement in mind, the Secretary of the Treasury stated prior to the second liberty loan that it would be necessary to float fourteen billions of bonds this year. That statement was entirely warranted with the facts before him. I believe the result will be a very much smaller flotation. I think the situation can be so managed that a total of so huge an amount of bonds need not be presented to the investing public.

Now, on the hypothesis of nineteen billions, we would have raised two billions from the first liberty loan, which was sold in the last fiscal year but paid for in this. We would get a minimum of three billions from the second liberty loan. Happily, it will be considerably over that. The optimistic view is that we will get four billion dollars from taxation. That would leave ten billions from additional bonds.

With the almost religious fervor that has been manifested in the sale of these bonds it is entirely possible that that amount of bonds could be sold, but in my opinion that amount of bonds will not be necessary. I would rather make a forecast—and remember that it is on the most inadequate data, that it is entirely personal and subject not only to what can be spent but what may still be appropriated and spent during the fiscal year—but I can guess that we might work the situation somewhat this way: receiving from the first liberty loan, two billions; from taxation, four billions; from short-term treasury certificates, let us say a possible total of four billions; from the second liberty loan now sold, somewhere between three and four billions; from War Savings Certificates, of which I shall speak later, possibly a billion. Now, with those resources there would be left only the task of providing from future liberty loans four or five billions to make the total nineteen billions—four or five, depending on whether three or four are realized from the loan just closed.

I see no reason why there should not be a very large amount of financing done with the short-term treasury note. The government has become the great purchaser; the government is conducting a great part of the business of this country. These short-term treasury notes are in effect government commercial paper. They are entirely proper for a bank to hold and there is capacity in the banking situation to readily carry the total of four billions. It would require but a shade over 10 per cent of the resources of each bank invested in these short-term treasury warrants to make up a total of four billions.

I want to explain something of the War Savings Certificates. I want to take you into my confidence and tell you just what we are going to do later with this scheme of War Savings Certificates.

In the act authorizing the second liberty loan, Congress granted authority to the Secretary of the Treasury to issue two billion dollars of War Savings Certificates. The act declared that they should not run over five years and that it was unlawful for a person to hold more than a thousand dollars. In other respects the matter is left wholly to the discretion of the Secretary. He has done me the honor of appointing me chairman of the committee to work out the details and the flotation of these two billions of War Savings Certificates.

We have had the experience of England, which has been extremely successful, but in viewing that experience we have decided to depart materially from the English plan. The English plan made the maturity of each certificate five years from the date that the money was paid into the post office. The date of payment, therefore, had to be officially noted, and the dealing, therefore, had to be entirely with the post office.

I desired to evolve a plan whereby people would not be confined to dealing with the post office, whereby there would be the greatest facilities for offering these securities for sale. It was necessary to have either a fixed maturity and a changing price or a changeable maturity and a fixed price. We chose the fixed maturity and the obligation of the United States will be issued as of January 2, 1918, to mature January 2, 1923. It will be in the form of a large stamp, printed in green, executed by the Bureau of Printing and Engraving. That stamp will sell in the month of January at four dollars and twelve cents. Four dollars and twelve cents at four per

cent, at compound interest, compounded quarterly, would amount to five dollars at the end of five years.

When a purchaser buys his first stamp he will be given a certificate on which there are spaces for attaching twenty of these stamps. When the purchaser buys his first stamp and attaches it to the certificate his name is written with his address and street address. He then has all the rights in respect to one stamp that he would have in respect to a certificate filled with stamps and there is the incentive to add more because of the vacant places. If he holds that until maturity, January 1, 1923, he can get at any post office, five dollars.

Now, it is the intention of the government that he should hold it to maturity, but if his exigencies are such that he needs the money before maturity, he can at any time, at any post office, on ten days' notice, receive what he paid, plus one cent a month in respect to each stamp. That is about 3 per cent—a little less than 3 per cent simple interest—so there is an advantage in his carrying it to maturity; but if he needs his money sooner he can get it at any post office.

Now, suppose he loses this. It will be contained in an envelope which will inform the finder that it is of value only to the owner, and the finder need do nothing but drop it into the nearest post office box without postage or further address. The post office will return it to the owner. Suppose a dishonest person finds it and undertakes to forge the name of the owner. If he does that successfully and the post office pays him, the owner has lost his money. If the document is burned up or otherwise disappears, the owner has lost his money.

The prospective purchaser may say, "That will not do. That is not satisfactory. I want greater safety." Very well, the government offers greater safety. If the owner chooses to go to a post office and have this registered, the stamps that he has attached to it are cancelled; if he will then go, whenever he attaches an additional stamp, and have that registered, he is then in a position where, if it is stolen, lost or destroyed, it is nothing more than a pass book and the post office will pay to the rightful owner, whether he produces his certificate or not.

For the purpose of accumulating four dollars in small amounts, the government will issue a small stamp, the size of a postage stamp. It is called a thrift stamp, costs twenty-five cents and there is a thrift card given upon which there are places for sixteen of these stamps.

When that is filled, it can be exchanged, with twelve cents or thirteen cents or whatever the price in the month of the exchange may be, for one of the other stamps that bear interest. These thrift stamps bear no interest.

Now we hope to raise two billion dollars with these small obligations. But that is the smallest thing that we hope to do with this scheme. We hope to impress thrift upon this people and we hope to carry over the idea that this country cannot produce twenty billion dollars of goods for the government unless people will be economical, unless they will refuse to employ, on unnecessary work making unnecessary things, the labor which the government needs upon the things that it requires for the war. That is the great lesson that we want to impress and the great good that I see that will flow from this War Savings Certificate plan.

And it is a lesson that must be learned not alone by the people who can save only in small amounts, but by everyone of us, and most of all by the business man who wants business as usual. It is impossible and utterly undesirable that we have business as usual. It is necessary that the whole available man power of this country be used for the purposes of the government; and the man is unpatriotic, no matter how much money he has in his pocket, who will employ labor to do an unnecessary thing and thereby compete with the government for labor.

I do not take a pessimistic view in the least in regard to the future of government finance. The demands that are to be made upon the Treasury are huge beyond anything that we have ever known. To illustrate how great they are, every expenditure that this government had made from 1791 to the beginning of this present year, through the War of 1812, through the Mexican War, through the great Civil War, through the Spanish War—every expenditure of every kind footed a little over twenty-six billions; and we are preparing to spend nineteen billions in one year! That measures somewhat the size of the task with which we are engaged.

But that expenditure is not all of the unproductive type. We are going to loan seven billion dollars of that nineteen to our foreign allies. We are going to spend considerably over a billion in the creation of a merchant marine. There are a great many expenditures that are of more or less a permanent character, so that it is not all wasted, not all gone.

But whatever the amount that it is necessary to raise and I must admit the difference is very wide between what the figures taken from one source or another might indicate—but whatever that amount is, there is capacity in the people to raise it. The first liberty loan, two billions in extent, was taken by the people, not by the banks. It was all absorbed within a very few weeks so that there was practically none left either in the investment account or in collateral in banks—the most amazing exhibition of financial strength. When the total of this last loan has been announced, we will know that that total will be another amazing exhibition.

The judgments of the Treasury in regard to the type of bonds, in regard to the amount, the form of offering, etc., have been proven to be wise. They were at variance at times with the advice of experienced men, but the advice of experienced men was at variance one with another. Results, it seems to me, have very fully demonstrated the wisdom of the Secretary of the Treasury in the various decisions that he has made in regard to government finance up to the present time.

I have gone back into the Treasury after an absence of sixteen years and I want to bear just a word of testimony to the efficiency of that great business machine. It is one of the most efficient business organizations in this country. I believed that was so when I was in the Treasury nearly twenty years ago. When I go back there and find men still occupying the high positions that they occupied when I was there, or other young men that I brought there, because of their trained ability, now occupying places of importance, I know that the Treasury has not been raided.

The Treasury is still the efficient machine that the government ought to have in this great crisis. I believe that we can look on the leadership that we are to have through this crisis with satisfaction, and I believe that whatever turns out to be the size of the task, the people are competent to meet it and will meet it.

WAR TIME BORROWING BY THE GOVERNMENT

By Mortimer L. Schiff,
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We have not been a borrowing nation and it is a new departure for us to have recourse to loans to provide for our needs. This is very apparent if we compare our national debt with that of other countries. Before the war, ours was only about $11 per capita, while that of England and Germany was about $75 each and that of France about $160. The war has changed this and, as closely as one can estimate, our per capita debt has risen already to about $70, while that of England and France is over $500 each and that of Germany about $350. We are dependent on our own resources, and it is our own people who must find the funds for financing our expenditures. We borrow at home and require no special safeguards for our bonds, such as some nations have been forced to provide in order to interest foreign capital. With us there are no questions involved of pledging certain revenues, of giving collateral security or of having lottery features. The simple promise to pay of our government is sufficient, and the main questions which our authorities have to consider are the amount and frequency of the offerings, the price of issue, the rate of interest, the length of time which the bonds are to run and whether they are to be taxable or not.

It is the policy of our government that its loans shall be offered for public popular subscription without discrimination, that they shall be issued at par and that no commissions or advertising expenses shall be paid. There can be no disagreement as to the first proposition, the second and third are somewhat open to question. European governments have never hesitated to issue bonds at a discount, realizing that this is simply a method of expressing the interest rate to be paid. In addition, there is a certain appeal to the investor in a bond at a discount, which is lacking in one issued at par, as experience has shown that in the former case there is as a rule more chance of the market price advancing towards par, than in the latter of its going to a premium.

As to the payment of commissions, European governments have found it of advantage to do this, not only in order to reimburse in this way banks, bankers and brokers in part at least for their out-of-pocket expenses, but also to encourage and stimulate competition among them in securing subscriptions. Much can be said in favor of this, and while it would help materially in placing our loans in this country, I think we can continue to do without it and rely upon the patriotism of financial agencies to do their utmost to secure subscriptions, even though it costs them money to do so. The same holds true of advertising expenses; with the mass of newspapers and publications of all kinds circulating in this country, the cost of paid advertising would probably be prohibitive, as all would have to receive consideration for political, if for no other reasons. The system, which Secretary McAdoo has adopted, of central committees in each federal reserve district, with a mass of local and trade committees to assist them, is probably the best method at our disposal to reach all the people of this country. It has been inspiring to see the readiness with which men and women have given their time and effort, to say nothing of their financial contributions. For instance, in the Second Federal Reserve District, about which I am best informed, it is estimated that the committee in the recent loan had made available to it by advertisers an amount of free advertising space which, if paid for, would have cost at least $1,000,000. This system of volunteer service has worked exceedingly well and has created a tremendous volume of enthusiasm and coöperation, which could hardly have been secured in any other manner.

The amount to be offered at any one time must be determined not only by the financial needs of the government, but also by the power of absorption of the public. England made her loan of last February an open one, with no fixed minimum or maximum, and secured over $5,000,000,000 from about 8,000,000 subscribers. Our first loan was limited to $2,000,000,000 and the recent one was in the nature of a compromise, with a minimum of $3,000,000,000 and an over-allotment to a certain extent permitted. Theoretically, the best way is an open loan in order not to be limited to the allotment of a definite amount. Each subscription then becomes an actual purchase and the machinery is much simplified. It is always easier to sell securities outright than to offer them for subscription, subject to allotment. This has been recognized in the last issue by the

acceptance of payment in full and allotment at once of subscriptions of less than $1,000, with immediate delivery of temporary bonds. The small subscriber does not want to sign a subscription blank, make a deposit and then go through a considerable amount of red tape before he gets the actual bond. He wants to pay for and receive his bond without any formality and with the minimum of bother. The same holds true to a great extent of those who are willing and able to take larger amounts. It seems doubtful to me, however, whether the country is ripe for an open offering and I am inclined to believe that the best results will be secured if we continue for the present, at least, the policy of offering a definite amount with a partial or possibly even an entire over-allotment permitted. The recent loan has furnished conclusive evidence that the American temperament requires the stimulus of having a mark to shoot at. It is apparent that the success of the offering was due primarily to every district, every locality, every agency knowing what it was expected to do and striving to provide its quota. The allotment of a definite share of the responsibility to each community and to every financial institution has proven its effectiveness, and I am convinced that if it had not been possible to make this appeal to local pride and individual rivalry, no such amounts of subscriptions could have been secured.

The matter of timing the offerings is fraught with considerable difficulty. It would be best, of course, if there could be a sufficiently long interval between issues to enable the accumulation of profits, income and savings, but with our enormous requirements, this may not be feasible and it may be that our offerings must follow each other in rather quick succession. England, however, has found it possible to let a longer period elapse between offerings and to rely in the meantime on receipts from taxation and on short time borrowing. Even in Germany, where there has been apparently very little, if any war taxation, there has been an interval of at least six months between issues. In the recent loan, we found that the response from corporate employes was inferior to that in the first loan, because they had not yet completed their payments on the bonds of the first issue to which they had subscribed and, therefore, were not disposed and probably not in a position to pledge any considerable further amounts of their wages and salaries in partial payment for subscriptions to the new issue. Another reason for avoiding, if

possible, offerings coming in too quick succession, is that both the public and the workers must be given a rest; otherwise enthusiasm is apt to be lessened and the issue may fall flat. The most effective method would be to so time our issues as to follow and have direct relation to military successes, or even failures. This would make the task of placing the bonds much easier on account of the psychological effect on the people of such happenings, but I realize that this procedure is hardly feasible.

The most important question which the Treasury Department has to determine in the case of each issue, subject of course to the authorization given by Congress, is the rate of interest, as with our policy of offering bonds at par, it is this which expresses the offering price and the return which the bonds yield. If our people are to invest readily in government bonds we must induce them to do so by offering them proper terms. It is all very well to depend upon patriotism for the sale of a certain amount of bonds, but the tremendous sums which this war requires to be raised by loans can be forthcoming only if the economic inducement to subscribe is proportionate to the yield of other investments. Experience, both here and abroad, has shown that while many subscribe from patriotic motives and with little consideration to the yield of the bonds, the main appeal must be based on the quality and attractiveness of the security itself as an investment. No citizen has the right in times of war to invest his savings as he likes, looking only to the security of the principal and the opportunity for profit. Business cannot and must not go on as usual during war and priority must be given the needs of the government, be they for steel, coal, money or any other commodity. But a fair price must be paid for money, just as for anything else, even though the government is entitled to the lowest possible interest rate and to have its needs supplied before those of private enterprise. The general trend of the investment market cannot be ignored with impunity. A certain margin between the yield of government bonds and those of other high-grade investments is permissible; if this margin is stretched too much the public may not respond. For the government to pay a liberal rate of interest on its loans is the wisest policy. It draws small and large savings to the Treasury and thereby discourages extravagance among the people at large, thus making it easier for the country to obtain the things it needs for the war. The rate of interest depends also on whether

principal and interest of the bonds are taxable or not and, if so, to what extent. It is readily seen that the higher the rate the less necessity there is for full or partial tax exemption, but on the other hand, if the rate is too high the effect on other securities is bad and may result in serious collapse. With our enormous requirements, however, we must attract all capital and savings, be they large or small. It has been said that making bonds tax free is a discrimination against the small subscriber, but is not the reverse also true? Why are not taxable bonds just as much a discrimination against the large subscriber, whose ready response to government loans is at least equally important? Would it therefore not be best if we offered the subscriber the option to take either a tax-free bond bearing a comparatively low rate of interest, or a taxable one at a rate approximating the return on high-grade taxable investments? The difference between the two could be about the average income tax on larger incomes, so that, except in special instances, which would probably not be very numerous, the net return of both classes would be substantially the same. Some specially situated might get some advantage from such a policy, but that can hardly be avoided when we are dealing with matters of such magnitude.

I favor the amortization of government loans by sinking fund payments, as heavy maturities are thus avoided. We are borrowing at low rates of interest compared to other belligerents, and are lending to our Allies at the same moderate rates. Would it not be better for us all if an amortization charge were added semi-annually so that repayment were spread over a number of years, instead of the entire amount coming due at one time? If such a policy were adopted it might be well to limit our special taxation for war purposes to an amount sufficient to provide for the interest and sinking fund on such bonds as may be issued. In fixing the method of repayment, we must have in mind not only ourselves, but also our Allies and be guided to a considerable extent by what is most convenient and least onerous to them. It may be necessary for this or other reasons for us to continue the policy of a fixed maturity, with the bonds subject to redemption at an earlier date, in whch case the maturity to be selected will depend upon various factors. If, in order to make the issue a success, a high rate of interest is necessary, the bonds should have a comparatively early maturity, as it is in the interest of the government that such a loan be refunded into a lower

interest-bearing issue at the earliest possible moment. It must not be overlooked, however, that the higher the rate the more desirous the investor is to insure the receipt of such return on his investment for the longest possible period and the longer the life of such a bond, the more attractive it becomes. Short time loans, such as our existing issues of Certificates of Indebtedness, are the easiest type of security to sell, as they have a special appeal to banking institutions and are for them a particularly attractive form of investment. But that is after all only temporary financing. In long time borrowing, the effect on posterity must also be considered. If the life of the bonds is very long, it is not fair to future generations; if it is very short, the burden is too great on the present one. The middle-road is probably the best, and I am inclined to think that unless the rate of interest must be materially increased, a maturity of from twenty to thirty years is probably the most desirable, both from the standpoint of the government and of the investor.

Of course, in the case of each issue, there are many questions of detail which must be settled, but as we become more experienced, these become simplified and more and more definite rules can be laid down. Such are the sizes of the pieces, the machinery of receiving subscriptions and of delivering bonds, the dates for payment, partial payment plans, terms of convertibility into future issues, war savings certificates and their relation to long time issues. The latter, as well as partial payment plans, are of great importance, as the loan of his savings to the government must be made simple and convenient to the small investor. It is towards him particularly that most of the educational work has to be directed and the result has shown that the man of moderate means and the wage-earner can be induced to invest in government securities, even though heretofore they may not have been buyers of bonds. The only class which it seems difficult to reach, are the farmers, and the response from them appears to have been unsatisfactory. It is strange that this should be so, as they are so prosperous. Their burden of taxation is comparatively light and the least we can expect is that they subscribe liberally to government loans.

The subscribers to small amounts find often considerable difficulty in providing for the safekeeping of the bonds they purchase. Most of them have no facilities for this purpose and many of them do not appear to have even a bank account. Many banks, trust

companies and safe deposit companies have offered their services free for the taking care of limited amounts of the bonds, but these small investors do not as a rule know how to go about it to avail themselves of these facilities, even when they are available. The government should provide some system by which the small subscriber would have a minimum of trouble and no expense in properly safekeeping the bond or bonds which he purchases. We might well follow the example of England and utilize the federal reserve banks in this country in a capacity similar to that of the Bank of England in Great Britain. As I understand it, any holder of British government securities can take them to the Bank of England, have them inscribed in one or more names and receive therefor a receipt, which is transferable only on the books of the bank. If the receipt is lost or mislaid the owner does not suffer as the inscription on the books of the bank is controlling and all that he has to do is to prove that he is the party in whose name the securities are inscribed. He need not produce the receipt, as long as he can prove ownership. Interest is paid by mail to inscribed holders, unless otherwise instructed, and if desired, the Bank of England will invest in government securities, the interest accruing to holders of amounts of less than £1,000.

Under the terms of the recent War Revenue Act, Certificates of Indebtedness issued under the act of April 24, 1917 and any subsequent act or acts are made receivable in payment of income and excess profits taxes. There seems to be no good reason why they should not be made receivable also in payment of federal inheritance or estate taxes. In fact, it should be provided that not only Certificates of Indebtedness, but all government bonds issued under any of the war acts be permitted to be used to pay the transfer tax on the estate of a decedent. Leaving aside any consideration of whether it is wise or proper to utilize an increased inheritance tax as a war revenue measure and to place special penalties on the accident of death during the war period, as well as of the fact that no provision is made for an abatement, if an estate changes hands more than once during a certain period, the actual payment of the tax should be made as little onerous as possible and such as to cause the least disturbance in the investments of an estate. As the law now is, the tax must be paid in cash within one year after the death of the testator, which means liquidation, possibly forced, of a considerable portion of an estate, while if the option were given to pay the tax

in government bonds or Certificates of Indebtedness, there would be a great inducement to wealthy men and women to keep a considerable portion of their capital invested in such securities, which after their death could be utilized for this purpose. An additional market for government bonds would thus be secured. An interesting provision of the English practice is that bonds are accepted in payment of death duties, excess profits duty or munition exchequer payments only if the bonds have been held continuously since the date of the original subscription or for a period of not less than six months immediately preceding the date of death or before such excess profits duty or munition exchequer payments become due and payable.

One of the greatest handicaps to the successful flotation of government issues is a weak and rapidly declining market for current securities. People do not feel encouraged to subscribe even to national loans when they see their other investments shrink alarmingly in value and when they find it impossible to liquidate except at great loss. Of course, the government cannot artificially stimulate prices, but it can avoid doing such things as cause loss of confidence and destroy real values. All that is needed is proper coöperation by all governmental agencies in seeing that business and industry are not handicapped. Fair rates for railroads, proper methods of taxation, sympathetic consideration of industrial problems and difficulties are far better selling arguments for government bonds, than myriads of posters or the most inspiring of speeches.

It is not within my province to discuss taxation or express an opinion whether the program adopted by Congress is a wise one or not. I wish only to point out that the investing power of the country is dependent to a great extent upon its ability to earn and save and that anything which affects this or handicaps business is certain to react unfavorably upon issues of government bonds. It has been said, that in the final analysis the tokens of exchange which we call money are but a convenient method of evidencing what they represent, namely, goods and labor. If this is so, and it seems to me sound, it follows that taxation is but another term for forced labor or commandeered goods, and government borrowing the acquisition of these by the state, with payment deferred until a later date, and rental—that is interest—paid in the meantime. In some communities, the option is still given the taxpayer to pay his local taxes either

in cash or by a certain number of days' work on the public roads, which is but an evidence of the recognition of this economic fact. There can be no doubt that the state has the right and is justified to commandeer or take without compensation a certain amount of the citizen's services or production, but it should not take more than he can spare without serious detriment to his standard of living or the proper development of his business. Otherwise, the result will be disastrous and its effect will be curtailment of industry, breakdown of efficiency, destruction of material prosperity and last, but not least, national discontent. Excessive or unscientific taxation is bound to have an unfavorable effect on government borrowing, as a discontented people will not respond readily to an appeal for its savings, to say nothing of the reaction on its ability to save. It has been said that the power to tax carries with it the power to destroy and that is certain to be the result of an unwise fiscal policy. Opinions may readily differ as to the amount to be raised by taxation, and the important consideration is not so much whether a larger or a smaller amount should be provided by a revenue bill, but the methods by which such revenue is raised. Taxation, in order not to interfere with government borrowing, must be based on sound and scientific economic principles and must not be haphazard in character to meet political or other considerations.

For the balance of its needs, after having recourse to taxation, the state must rely mainly on the sale of its bonds, that is, on borrowing the labor and goods of its people. This lending of their services and production must be voluntary on the part of the people, but the man who does not place at the disposition of the government at least part of the cash proceeds of his labor or goods is just as derelict in his duty as he who otherwise eligible avoids military service.

In order to make available the enormous sums which the war will require this country to raise by bond issues, the government must be prepared, if necessary, to monopolize the investment market. Not only can corporate securities not compete with those of the nation in their appeal for the savings of the people, but even state and municipal bonds, attractive as they may be on account of their exemption from taxation, must give way to the federal necessities. As long as governmental offerings are limited in amount and issued only at infrequent intervals, there may be room for the utilization of some of the national resources for other financial requirements, but

as soon as one government loan follows another in quick succession and for large amounts, the financial exhaustion is apt to be such, as to prevent the successful placing of other securities. It may be said that other borrowers can tempt money out of the pockets of the people by the attractiveness of the terms they offer, but even if this is possible, it should not be permitted in the interest of the country at large. The truest democracy lies in the subordination of the individual to the common good and the needs of the nation must be paramount. But how then are corporations and our political subdivisions to finance those needs, such as refunding and absolutely necessary addition, betterments and improvements which are imperative and cannot be postponed, if they are unable or not permitted to sell their own securities? It seems to me that there is but one logical answer to this question. The national Treasury may have to provide funds for this purpose just as it is financing the needs of our allies in this country. Our Allies must have the goods which we and we only can supply and our government is furnishing them with the credit with which to make payment, not only because that is the principal contribution which we can make at the present time to the battle against autocracy and brutality, but even more so because no such sum as they need could be found in the investment market of this country and what could be provided would be at such prohibitive cost as to interfere seriously with the financial stability of everything else. The same holds true of our own internal needs, and it is very apparent that heavy taxation and government borrowing has had its effect already upon the ability of our corporate enterprises to raise money. Look at the basis upon which prime railroad, industrial and public service bonds are selling, figure the cost of recent corporate financing and there can hardly be any doubt that the end is almost at hand, if not already reached.

The only securities which can compete are state and municipal bonds and that because they are free of all taxes. This is apt to make them more attractive to the large investor than government bonds when issued as entirely or partially taxable. Some means may have to be found to control the amount and time of such offerings and if the government should have to come to providing funds for the imperative needs of corporate enterprise, it may, even though not for the same reason, have to include in such a scheme provision for state and municipal requirements. Some may fear that the acqui-

sition by the government of corporate securities would be a step towards government ownership, but it does not appear to me that such reasoning is sound. These securities would be obligations, not stock, the relationship of the government would be that of creditor, not of owner, and the bonds and notes thus acquired would be in such form as to be readily salable after the war. In fact, it is probable that this could be done at a profit when normal conditions are again restored. Needless to say, the greatest possible safeguards would have to be adopted, so that there might be no abuse in securing government aid. If the time should come when such issues must be curtailed or even prevented, the most effective means of control and supervision would probably be through a central board, with power, possibly subject to review by the Secretary of the Treasury, to deal with this situation. Legislation may be necessary for this, but the main reliance would have to be placed on coöperation of public officials and of corporate managements and on the force of public opinion, which would probably be effective. This is not the time or place to discuss the details of such a scheme, and I desire only to point out that it is most important, if such a board should be appointed, that it consist of experienced men and be so constituted as to avoid any risk of outside considerations affecting any of its decisions of the important questions with which it would be called upon to deal. It would have to be assisted by regional and advisory committees, so that the best local opinion and technical judgment could be secured. All of the belligerents and some of the neutrals as well have found it necessary during the war to establish supervision and control over the financing of capital expenditures by public issues and to limit the demands for capital on their markets. If the war continues for any length of time, we also may have to do something on these lines in order to make all of our funds available for the government.

Few people seem to grasp how enormous our war requirements are. Congress has thus far appropriated over $21,000,000,000, and it is estimated that over $19,000,000,000 of this amount will be actually spent during this fiscal year ending next June. There is, of course, no such amount of money available in this or any other country and credit must be created to take care of these tremendous needs. We must win this war and make every sacrifice necessary to do so, but it must not be overlooked that there is a limit

to what even a country as rich as ours can provide. There should be, of course, no niggardliness or false economy, but on the other hand, extravagance must be checked and unwise expenditures avoided. This has a direct bearing on government loans. The people must feel that the money they provide is being spent wisely, otherwise they are apt to hold back. We must bear in mind that even our purse is not bottomless and our resources without end. There is a limit to what can be raised safely by taxation. There is a limit to the power of absorption of government loans. There is a limit to expansion of currency. As the war goes on, we must have recourse to all these methods of raising money, but the last must be used only on sound economic lines and with the utmost caution. We must avoid greenbacks, and any creation of additional currency should come through the federal reserve system, which is amply able to provide for a large expansion on a sound basis. Upon the present amount of gold held by the federal reserve banks about $2,000,000,000 more reserve notes could be issued than are at present outstanding and even that great amount can be increased by the Federal Reserve Board by decreasing the gold reserve required. In order to thus expand our currency, eligible commercial paper and acceptances must be provided. We need additional currency to support our government loans, and the industries of the country and individuals must furnish the basis for the enlargement of our currency supply. Our people must learn to borrow and our banks to rediscount. This is the way to provide the credit needed by the government. It is a circle which produces results. Current savings are not sufficient; the people of the country, merchants, manufacturers, farmers and wage-earners, must pledge their future savings as well. They must borrow from their banks and invest in government bonds the funds thus received. The banks in turn must rediscount their customers' notes at the federal reserve banks, and additional credit facilities are thus created. The money thus furnished the government returns to the people through the channels of trade and thus becomes available again for further investment in government bonds. This process may be pyramiding, but it is economically sound, as it is self-liquidating as the people of the country repay their debts out of their savings and out of the proceeds of their production, be it labor or goods. To accomplish this, our people must be taught to save and avoid unnecessary expenditures.

Our banks also must be educated to make full use of their rediscount facilities. Some of them still seem to think that to avail of the federal reserve banks' facilities is the same as taking out clearing house certificates in times of panic and that it is a sign of weakness if their statements show that they have rediscounted. I cannot emphasize too strongly the need of economy and of the public availing freely of the borrowing facilities which must be provided, as on these depend primarily the successful flotation of bonds of our government.

I have not ventured, nor do I propose to outline or recommend any definite plan for borrowing by our government or to express an opinion as to what the amount, rate of interest, maturity or time of issue of the next or future offerings should be. All these are matters which the Secretary of the Treasury must determine when the time comes with relation to conditions and requirements as they may develop, and I am confident that we can rely with safety in the future, as we have in the past, on his wisdom and good judgment and on that of his advisers. Not only can no hard and fast rules be laid down as to the exact form which government loans should take in this country, but it would be presumptuous for me to try to do so. All I have attempted in this paper is to present a brief outline of some of the factors which must be considered in connection with government borrowing, and certain principles which seem to me must be observed, not only to ensure a ready popular response to bond offerings by our government, but also to make it possible for the enormous sums needed to be forthcoming. These requisites, which, in my opinion, are of paramount importance, I would summarize as follows:

There must be no hampering of enterprise by unwise or too onerous taxation.

The public must not be discouraged and values must not be jeopardized by an unfriendly attitude by the government towards business. Capital as well as labor must be permitted to earn a fair return.

Issues of government bonds must not be too frequent and must not exceed the absorption power of the people. There should be, if possible, sufficient intervals between offerings to enable accumulation of profits, income and savings and to prevent exhaustion and lessening of enthusiasm among those actively engaged in placing the bonds.

A fair rate of interest must be paid and one not too much lower than can be secured from other prime and readily salable investments.

There should be no discrimination between large and small investors and, in so far as possible, the net return to all subscribers should be substantially the same.

The fullest possible facilities must be provided for borrowing by the people of the country and the federal reserve system must do its full share to make available its resources for this purpose.

The national government must monopolize the investment market if necessary, and is entitled to have its money requirements supplied before and, if need be, to the exclusion of those of private enterprise or even of states or municipalities.

Last and most important, the people must be taught to save and all unnecessary expenditures must be avoided. Thrift and economy must be the rule.

LOANS VERSUS TAXES IN WAR FINANCE

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The fiscal problems of the war may be divided into those of a general and of a specific character. War expenditures can be met in three ways: by taxes, by loans, or by paper money. The specific problems have to deal with the nature and the details of each of these expedients; the general problem is concerned with the principles that underlie the preference among the respective methods. Inasmuch as paper money is by common consent to be regarded as the last resort, the general problem at issue here pertains to the choice between loans and taxes and the relative proportions in which each is to be employed.

If we look at the facts we observe a marked change in modern warfare. In former times, whether in classic antiquity or in the Middle Ages, the expenses of war were defrayed in large measure out of accumulated funds or treasures reënforced by taxes, and were reimbursed to the victor by the booty of war and the indemnities imposed upon the vanquished. Since the development of public credit, especially since the middle of the eighteenth century, loans have taken the place of the accumulated treasure and taxes have been utilized chiefly for the purpose of raising the interest on the war loans and of furnishing in addition a more or less considerable amortization quota.

The facts of the present war are no different. During the last fiscal year Great Britain raised by taxation slightly over 17 per cent of her war expenses; Italy, although also levying heavy taxes, has raised a still larger proportion than England by loans; in Germany only an insignificant fraction of the war expenses has been met by taxes; in France, as a result partly of the occupation of its territory by the enemy, the taxes hitherto levied during the war have not sufficed even to pay the ordinary peace expenses; while Russia has been in a still worse position. Although there is indeed a notable difference between the zero of France and the 17 per cent of Great Britain, the fact remains that in all the countries, with-

out exception, the overwhelming proportion of war expenditures has been met through loans.

The same thing is true of the United States. We have been told that our war expenditures for the present fiscal year will be about nineteen billions while the sum to be yielded by the new revenue bill is about two and a half billions or about 13¼ per cent of the whole. Even if there are included about one billion of peace expenditures and if we add that part of the previous tax revenue which might fairly be chargeable to the war or to war preparation, the proportion to be raised by loans will not differ materially from that of England. If we should exclude from the war expenditures the seven billions to be advanced to our allies, the amount to be raised by taxation, under the new revenue bill, would even then only be slightly over 21 per cent of the whole.

Several months ago an American economist[1] made the following statement: "I am strongly of the opinion that a great modern war, enormously costly as it is, can and should be mainly, if not entirely, financed from the proceeds of taxes collected during its progress."

Similar opinions have been voiced by others and have found expression in Congressional speeches, and a more or less faint echo of that pronouncement has even been audible in certain statements emanating from the executive branch of our government.

Why have the actual methods diverged so greatly from these suggestions? How does it happen that the statesmen and the legislators in every belligerent country, including our own, have done the opposite? Why, instead of raising from 50 to 100 per cent by taxes, has none of the belligerents raised as much as 20 per cent, or, at the outside, 25 per cent, of the war expenses by taxes? Shall we convict the European and American statesmen of folly and fiscal madness? Or is it perhaps true that the suggestions, so unavailingly made to the contrary, have been based upon an inadequate analysis?

This is the problem to which we shall now address ourselves.

I. What Do We Mean By War Costs?

The first point in our analysis is to ascertain what is meant by the costs of war. It is obvious that a distinction must be made between the money costs and the real costs of a war. The money

[1] O. M. W. Sprague, "The Conscription of Income," in the *Economic Journal*, March, 1917, p. 2.

costs of a war are the actual outlays of the government for war purposes, that is, the surplus above the general expenditures in time of peace, making due allowance for changes in the purchasing power of money. The real costs of a war, on the other hand, are to be calculated very differently. When the ordinary man speaks of wealth he thinks of accumulated capital. The more sagacious thinker, however, is aware that the real wealth of a community consists in larger part of the results of current production. Accumulated capital is of importance chiefly as an aid to current production. It has been calculated that the world is always within a year and a half of starvation. If current production were suddenly to cease, the world's stores of food and other products would barely suffice for eighteen months. A wealthy country is one where the consumption of the people is great and variegated and where the current production is so large that there will still be a substantial surplus susceptible of being converted into capital for future production and into an environment which will spell increasing welfare and civilization. A great war interferes rudely with the results both of past accumulation and of current production. The real costs of a war are to be measured by the diminution of the social patrimony and by the diversion of current social output from productive to unproductive channels, *i. e.* by changes both in the fund of accumulated wealth and in the flow of social income.

In drawing up the balance sheet we should have to put on the one side the diminution of the fund of wealth as represented by (a) the destruction of private property, (b) the loss of government accumulations, (c) the impairment of natural resources and (d) the decrease in the social output due to the reduction of the labor force by military service and the fortunes of war. On the other side of the ledger, indeed, we should have to put such capital items as (a) indemnities or booty, and (b) the acquisition of new territory; and on the income side, the results of (c) speeding up of production, (d) the more favorable economic situation attained by the political results of the war, and (e) changes in the methods of industry and the relation of capital and labor which may conduce to greater efficiency and increased output.

Although not all of these items are susceptible of being put in terms of dollars and cents, the real costs of a war may be characterized as the balance of the debit side over the credit side in the above account.

While this contrast between the money cost and the real cost of the war is important, it does not yet go to the root of the matter. In order to grasp what is meant by the real costs of a war, we must revert to the distinction familiar to the student, but so often neglected in popular discussion, between objective and subjective costs.

By objective costs are meant the costs incorporated in the goods, commodities and services that are used for the war, that is, the money value of all materials consumed and all services furnished for war purposes. In contradistinction to the objective costs, however, are the subjective costs. The essential idea here is that of sacrifice. The production of everything costs some sacrifice and all sacrifice involves pain, either the pain of doing something distasteful or of refraining from doing something pleasurable. Sacrifice in other words is involved both in labor and in abstinence. The surplus of results over subjective costs constitutes the welfare or the real wealth, both material and immaterial, of society. In a community based upon slavery or where the laborers, with an abject standard of life, are compelled to work sixteen hours a day, there may be a great surplus of production and in that sense great wealth. If, however, slavery is abolished or the laborers acquire a shorter working day and a higher standard of life, not only may there be the same output of material things as before, but there will be a greater surplus over subjective costs, and, as a consequence, an increased communal welfare and a higher stage of civilization.

As a result of the machinery of our social order subjective costs are commonly translated into objective and money costs. If a machine is invented which cuts in half the period needed for the production of a particular commodity, we speak of halving its cost. Instead of two men being required to accomplish the result, only one man is now needed. So far as the community is concerned, the subjective cost or sacrifice is reduced; and under a state of competition, this decrease in subjective costs will reflect itself in smaller objective costs and lower prices. So, in the same way, just as the greater efficiency of the laborer will result in a larger output of material commodities, the greater abstinence involved in the ordinary economy practiced by the members of a community will be followed by an increased accumulation of productive capital. The subjective costs involved in economy are undoubted, but the additional results which ensue from the practice of economy are so much

greater that there remains a substantial surplus. In other words net sacrifice or burden is diminished. The real wealth of a community depends upon net sacrifices or subjective costs. Where the same output is attended with less sacrifices we have prosperity. Where increased sacrifices result in still greater output we again have the prosperity that goes with lessened net subjective costs. When, however, economy changes into privation, the increased material results may be too dearly purchased: although there may be more material wealth for the present, there is less real wealth or welfare because there is more net sacrifice. So, in the same way, when increase of production is attended with the sapping of the vitality of the labor force, the nominal efficiency really becomes inefficiency and the greater material wealth of the present signifies less real wealth or welfare. The total net burdens upon the community are greater.

The important criterion in the economic welfare of a community is therefore the subjective cost or sacrifice. This is as true in war as in time of peace. Just as the subjective cost of an individual consists of the effort involved in labor and the abstinence involved in the foregoing of enjoyments, so the subjective costs of a community due to a war consist of the burdens of additional labor which it must expend and the diminished consumption of goods and services which it must forego. The objective costs of a war are material commodities and services; the subjective costs of a war constitute the real burdens resting on the community. The true costs of a war are the net sacrifices or subjective burdens which result from the transition from a peace economy to a war economy, and which are connected with the fundamental processes of production and consumption. They consist, on the one hand, of all the efforts involved in the transfer of enterprise and investments from the ordinary channels of production to the new fields of primary importance in the war. They consist, on the other hand, of all those efforts involved in the reduction and the change of consumption which will serve to counterbalance, in part at least, the inevitable reduction of social output. The net result measured in terms of aggregate sacrifice or subjective cost constitutes the real burden of a war. The problem that confronts us is to analyze the results of various fiscal expedients upon these changes in production and consumption from the point of view of the subjective costs or the real burdens resting on society.

II. CAN THE COSTS OF A WAR BE DIMINISHED IN THE PRESENT OR BE SHARED WITH THE FUTURE?

After this preliminary explanation we may proceed to consider how the costs of a war can be diminished in the present and in what way, if any, they can be shared with the future.

So far as objective costs are concerned, it is manifest that they belong, for the most part, to the present. The services must be performed by men now living and the commodities consumed in the war must be produced before they are consumed. In several respects, however, the present may benefit at the expense of the future, even so far as objective costs are concerned. These considerations deal respectively with capital and with labor.

In the cost of production we ordinarily include sums set aside for depreciation of plant. It is possible, however, that the exigencies of the war situation may require such an immediate increase of output as to divert to current production the funds which would otherwise be devoted to the maintenance of plant. The result is that the future will possess a less effective plant than would otherwise be the case. Or, in the second place, the capital diverted to purposes of war production may become useless after the return of peace. Thousands of munition plants, for instance, may have been constructed solely for war purposes with machinery that it would be difficult or even hopeless to convert to other purposes. The capital which would otherwise be available at the conclusion of the war for peace production will to this extent have been lost. The production in the future will be less than would otherwise have been the case.

What is true, however, of capital, is equally true of labor. It is possible that the speeding up of production involves such a strain on the laborers, resulting from long hours, night work and unremitting toil, as to impair their health and transmit to the future a body of workmen less efficient than they would otherwise have been. It may take some time, either by the more careful handling of the then existing workmen, or by the immigration of men of a higher standard and stronger physique, before the balance is restored. And, on the other hand, while a diminished consumption is assuredly desirable during a war, the enforced decrease of consumption which may result from the fortunes of war may bring about such privation in the mass of the community as to sap their energies and reduce their future efficiency.

In all of these ways, the burden of the present may be lightened at the expense of the future. There is more production, that is, more commodities and services now, but there will be relatively less in the future. Even in the case of objective costs the present may benefit at the expense of the future.

Subject to these limitations and exceptions, however, it may be said that the objective costs of a war are, in the main borne by the present. This is true irrespective of whether the expenditures designed to furnish these commodities and services are met by loans or by taxes.

When we deal with subjective costs, however, the situation is very different. Subjective costs may be reduced without any of the burden being shifted to the future; or they may be diminished while a part of the burden is borne by the future. It is obvious that neither of these results can be obtained by the process of taxation. The tax imposed upon the present generation may indeed have some repercussion upon the future. If an excessive tax is imposed upon capital, it may so reduce existing resources as to make future production smaller. Even if the tax is not excessive, the taxpayer, instead of decreasing consumption or paying the tax out of current income, may draw on the funds which he would otherwise have devoted to productive purposes. Or, finally, if an excessive tax is imposed upon incomes or profits, it may so diminish the tendency to enterprise that the baneful consequences will endure. In all these cases, however, although the future undoubtedly suffers, there is no diminution in the burdens that rest upon the present. The present taxpayers bear the burden, even though the future taxpayers also bear a burden.

Is the same true in the case of loans? Can the burden upon the present be lightened by the issue of government loans? Are the subjective costs or sacrifices of the community in any way lessened by government borrowing? This brings up for consideration the theory of public credit.

The theory of credit, as it has been worked out by economists, is in reality simple. Credit is a phenomenon or transaction in which a part takes place in the present and a part in the future. If I lend a man money, I turn over to him now a certain sum and he turns over to me in the future the equivalent of that sum. When the sum has been paid the transaction is complete. If we deal with public

instead of with private credit, the situation is identical. The funds are turned over now by certain classes in the community who loan the money to the government and the transaction is concluded in the future, when the taxpayers furnish the money to return it to the bondholders.

How does it happen then that the utilization of credit diminishes the burden upon the present? How can the subjective costs of the war be lessened for the community?

In the case of private credit the subjective sacrifice of the individual is clearly diminished. This is obviously true of productive credit for otherwise credit would not have become so vital a fact in our modern industrial life. The reason why the business man borrows today is chiefly because he thinks that with the borrowed funds he can secure such a return as to insure an enhanced profit even after paying all interest as well as repaying the capital borrowed. The credit, therefore, in so far as it enables him to purchase more goods with the same outlay, or—what is the same thing—the same amount of goods with a smaller outlay, lessens his subjective cost. Moreover, not only is his subjective cost or sacrifice less, but his objective cost or outlay as compared with the return, is also smaller.

Even, however, if we deal only with consumption credit, that is, with money borrowed for mere purposes of consumption, the borrower may enjoy a gain. Although he is thoroughly aware of the fact that he will have to repay in the future, with interest in the meantime, the precise sum that he now borrows, he is nevertheless anxious to borrow. This is due to two facts: an underestimate of the future, and the possibility of repayment in instalments.

His sense of immediate need is much stronger than his recognition of the sacrifice that he will have to make in the future in order to repay the loan. It is the same feeling that overcomes us when we compare the foregoing of a good dinner tonight with the foregoing of a good dinner a year hence. Our present sense of sacrifice, that is, our real subjective cost, is smaller in the one case than in the other. This is true even though we may, at the end of the year, regret our action. In ordinary cases, however, the action will not be regretted but will be repeated another year.

But, secondly, and more important, private credit diminishes subjective costs not only by the mere process of deferring payment

but by making possible repayment in instalments. The essence of the situation is found here in the gradualness of the repayment. The aggregate burden of gradual repayment is less than the sacrifice involved in providing for the whole of the original amount outright at once. The individual who borrows may incur a gain despite the obligation ultimately to return the same aggregate amount in the future. If he did not incur this gain he would not continue to borrow.

We are now in a position to grasp the social importance of credit. Credit increases prosperity. If used for productive purposes, credit, while indeed not capital, works like capital and constitutes an aid to production. It renders possible the same amount of output with a smaller cost or sacrifice. It accomplishes this by taking the funds out of the hands of those to whom it is worth relatively little and putting it into the hands of those to whom it is worth more because they make it yield more. The man who lends money at 6 per cent does so presumably because he has a surplus capital from which he is content to receive 6 per cent interest. But the man who borrows the fund expects to make more than 6 per cent interest and to retain the surplus in the shape of profit. Could the lender utilize the fund profitably in his own business he would not lend the fund. But even where credit is utilized for purely consumption purposes, it is equally advantageous, because by deferring payment and by rendering possible repayment in instalments rather than in a lump sum, it lessens subjective costs or sacrifices. The social utility of credit is therefore quite clear. It increases the wealth of the community by lessening the subjective sacrifices of certain individuals and putting at the disposal of the community funds where they will be utilized to the greatest advantage, thus decreasing costs and increasing output. Society as a whole is thereby enabled to employ those services which can be more easily dispensed with.

The truth of this assertion is not invalidated by the fact that credit may be abused. If the man who borrows at 6 per cent puts the money into a business which does not earn 6 per cent, the community, as well as himself, suffers for his mistake. So, in the same way, if an improvident individual borrows for consumption purposes and finds that he becomes more and more hopelessly entangled with the passage of time, he may find it impossible to meet the debt

even in instalments and his easy-going reliance upon the future may cause his ruin as well as loss to the lender. Because, however, an essentially sound institution may be abused is no argument against its essential soundness. Credit, like speculation, would not have become the outstanding feature of our present economic organization if it did not fulfill a socially useful function. The modern economy is essentially a credit economy.

Public credit shares this character. The chief difference between public and private credit is in the relation of consumption credit to production credit. While the government, like the individual, often borrows for productive purposes, as for a government railway or a municipal subway, most existing national loans are the result of consumption credit. It is fairly well agreed that just as a prudent individual ought not to borrow for purposes of ordinary consumption, so the government ought not to borrow to meet its current expenditures. The real differences arise when we consider extraordinary expenditures.

There are three points in which public credit differs from private credit. In the first place, extraordinary expenditures for unusual consumption are not so apt to occur in the case of the individual as in the case of the government. Most individuals are able to provide a reserve fund against a rainy day. Government revenue, however, ought properly never to exceed current expenditures. As a consequence, when an extraordinary emergency arises, as a war, the utilization of consumption credit becomes legitimate. In the second place, the individual lives only his own life; if he borrows largely for consumption purposes he will not always find it easy to repay the debt. The state, on the contrary, is eternal. The government, accordingly, has a much longer time in which to pay off a debt. If, for any reason, it becomes desirable to postpone the payment of the debt to the distant future, the justifiability may be stronger in the case of the government than in the case of the individual.

In the third place, what seems to be consumption credit may, in the case of the government, partake of the characteristics of production credit. A legitimate war is either for defensive purposes, that is, to maintain the existence of the state, or for offensive purposes, in order to procure for the state certain territories or rights to which it thinks itself entitled. Since in both of these cases a foun-

dation is laid for continued or even greater prosperity, the expenditures may in a sense be called productive in their nature. Whether a particular war is actually of that character may be a question; but surely no nation will enter upon a great war unless it is deemed legitimate. And if the general sentiment of the nation justifies the war, if the ends to be achieved transcend the sacrifices that are incurred, the war expenditures may be considered in the broader sense of the term productive.

For these three reasons, therefore, public credit may be considered even more important than private credit. Just as private credit is socially useful or productive of wealth and welfare, so public credit may be at least equally beneficial. Its utility consists in the fact that, through borrowing from those in possession of the capital rather than taxing all the members of the community, whether or not they have the capital, it lessens subjective costs or sacrifices and puts at the disposal of the government those services in the community which can be most easily dispensed with.

It might be claimed that the advantages of private credit do not attach to public credit because in the one case we are dealing with different classes in the community, and, in the other, with the community as a whole. Why would not the same advantages be secured, it might be said, by taking from the possible lenders the same amount in the shape of taxes? This argument, however, is really invalid. For the situation contemplated is not only most unlikely but virtually impossible. Under every system of taxation which has hitherto existed—in democracies as elsewhere—we find some taxes at least levied on business, on consumption, on exchange and on other sources than wealth. Even, however, if the tax system were to be so changed as to consist exclusively of taxes on accumulated wealth and incomes, it by no means follows that the funds would be forthcoming from the individual taxpayers in precisely the same proportions that they would have been supplied by the individual bondholders. For some recipients of large incomes, at least, would surely give up a greater sum as an investment bearing interest, than they would hand over as a forced contribution representing a dead loss. The psychology of the situation consists in the difference of the reaction to a voluntary as contrasted with a compulsory act. Even if only a few individuals contributed it would still remain true that the utilization of public credit would

in this way put at the disposal of the government the services in the community most easily dispensed with. In order to invalidate this statement it would be necessary for the government to take by taxation from each individual absolutely everything above the necessary means of subsistence. Only then would this particular argument as to the advantage of loans over taxes lose its force.

But even in this most unlikely case, where precisely the same sums would be raised from each taxpayer that would otherwise be contributed by each bondholder, it nevertheless remains true that loans imply a lessening of subjective costs or sacrifices. For although the taxpayers of the future have indeed to repay the loan, they do not have to pay the amount all at once as would be necessary in the case of the sums being raised immediately by taxation. Just as in private credit the aggregate burden of gradual repayment is less than the sacrifice involved in outright provision of the original amount, so in the case of public credit the social sacrifice involved in the periodic payment of the smaller sum represented by the interest and amortization charge is less than the burden involved in providing the entire amount in a lump sum. The phenomena of interest and of credit, by their very nature, imply that the burden of a successive series of partial payments is less than the burden of the total original payment. Just as the individual who borrows may incur a gain, despite the obligation to return the same amount in the future, so the community which borrows may incur a similar gain. This net gain in the case of public credit is represented by the smaller burden involved in the amortization quota.

If, then, it is true that the utilization of public credit may involve a lessening of subjective costs or real burdens upon the community, can it in the second place accomplish this by transferring a part of the burden to the future?

It might plausibly be argued that this is impossible. It might be said, for instance, that while it is true that the future taxpayer suffers a burden in so far as he has to pay taxes in order to raise the funds which are due to the bondholder, the only result is a transfer of the burden from one class in the community to the other. The taxpayers, it might be said, suffer a disadvantage, but the bondholders who have their loan repaid to them secure the benefit. Since the benefits counterbalance the disadvantages there is no net burden.

This argument, however, is fallacious. When the bondholder

invests in the loan he suffers indeed a sacrifice in the sense of giving up the funds which he might otherwise employ. This sacrifice indeed is compensated and more than compensated by a benefit. The benefit, however, that accrues to him is to be measured by the annual interest that he receives on the bond. If he had not invested in the government bond he would have invested in something else or would have allowed his money to remain in the bank. In any case he would simply have gotten interest on his capital; and it is immaterial whether his capital is represented by a deposit account in the bank or by a private security or a public bond. The benefit that the bond-holder receives in return for the sacrifice of yielding the money is the accumulated annual interest on the bond. By the time that the bond falls due there is no more benefit accruing to him. The bond is always salable at the market price. Even before it falls due, the holder can dispose of it and get as much as he could have gotten by waiting until the expiration of the loan. If, as often happens, the bond stands at a premium, he could even get more by selling it before hand. Or if he does not dispose of his bond, he can utilize it as security for a bank loan just as he would otherwise utilize an industrial bond or any other security. In reality, therefore, instead of speaking of a benefit accruing to the holder when his bond is paid off we ought really to speak of an additional burden or sacrifice imposed upon him. For now he will have the trouble of reinvesting the funds. Long-time bonds are in fact generally preferred by the investor in order to obviate this necessity of reinvestment. The fallacy involved in the contention that the sacrifice imposed upon the future taxpayer is counterbalanced by the benefit accruing to the bondholder thus consists in the failure to realize that there are no benefits then accruing to the bondholder. Whatever benefit may have accrued to him consists in the safekeeping of his money and the annual interest that has been paid. When the bond falls due the benefits cease. There is, if anything, a burden rather than a benefit now accruing to him.

There is another fallacy lurking in the statement that the burden upon the future taxpayer is compensated by the benefit then accruing to the bondholder. There is indeed a burden upon the future taxpayer but not of the kind imagined. Public debts of large amounts are never paid in the manner supposed. When a public debt falls due it is not paid out of the proceeds of taxes levied

upon the taxpayers of that particular year. If the debt is not refunded, but actually paid off, it will be extinguished by utilizing the funds which have been accumulated for a term of years. If there is a sinking fund, the burden upon the future will be represented by the annual amortization quota. In such a case the burden will be borne not by the taxpayers at the time when the bond falls due, but in instalments by the successive annual taxpayers beginning with the year when the bond was first issued. The same is true if the bonds are serial bonds the instalments of which fall due periodically. In this case only the burden representing the last instalment will be borne by the taxpayers at the expiration of the loan. If we take the sinking fund bond as a type it may be said that the benefit accruing to the bondholder is represented by the accumulated interest and that the burden resting upon the taxpayers is composed of the entire debt service, that is the interest charge together with the amortization quota, since the interest charge figures on both sides of the ledger as benefit and as burden. The amortization quota is the net burden resting upon the successive contingents of taxpayers until the sinking fund is completed or the debt is entirely paid off. That this net burden upon the future may be outweighed—and in general more than outweighed—by the net benefit accruing to the present has been indicated above.

We may, therefore, consider it as established that it is possible, not only to diminish the subjective sacrifice on the present, but also to put a share of the burden upon the future. It has also been established that the device of public credit necessarily accomplishes the second result in effecting the first. The problem at issue is the cost of making final settlement of the war bills of the government. This settlement must be made by taxpayers and it can be postponed. If the government borrows it obtains money from people who get a good investment and who are making a very slight sacrifice. The sacrifice on the part of a purchaser, rich or poor, of a liberty bond is much less than the sacrifice of a taxpayer who gives up his money without return. The sacrifice of the taxpayers who must pay the bills can be postponed and this postponement may involve the undoubted advantage of spreading large payments over a period of years.[2]

[2] Mr. Hartley Withers, who originally held this view, has been so influenced by the rather hasty pronouncement of some American writers that he has recanted. *Cf.* his *Our Money and the State*, 1917, p. 29. But even he balks at

Public credit, if correctly employed, may, in shifting a part of the subjective sacrifice to the future, lessen the total real costs of a war on the community as a whole, viewed as a continuing entity.

III. OUGHT THE BURDENS OF A WAR BE SHARED WITH THE FUTURE?

Although it is possible as we have just seen to shift a part of the burden from the present to the future, the next problem is as to when, if ever, this is justifiable. The point at issue here, be it observed, is not as to the relative advantages of loans *versus* taxes, but as to the classes of cases when loans are to be permitted as a matter of principle. In order to solve this problem we need a more detailed analysis of public expenditures.

For our purposes all public expenditures may be divided into two classes: current and capital expenditures. Current expenditures are those incurred for carrying on the ordinary business of government while maintaining its property or plant at the customary level. Capital expenditures are those incurred for increasing the property or plant of the community.

Capital expenditures may again be divided into expenditures for self-supporting and for non-self-supporting purposes. Expenditures of the first kind are seen in the case of water-works where the revenues are expected to defray more than the cost. Here it is entirely legitimate to issue bonds, because although the burden upon the present is diminished there will be no burden upon the future. By the time the bonds expire, a sinking fund will have been accumulated out of the revenues which will also in the interval have provided for the payment of the annual interest. It is for this reason that in the city of New York, for instance, not only the water and dock bonds, but those issued for any municipal improvement the revenue from which will defray the interest together with an amortization quota, are by law excluded from being counted in the debt subject to constitutional limitations as to size. If such

the proposition that public borrowing is always unjustifiable, and accepts it as defensible when employed for productive purposes (*Ibid.* p. 43). Had he pushed his analysis a little further he would have realized the fact that no distinction can be drawn between consumption and production credit, and that the economic utility of credit may attach equally to both forms.

improvements had to be paid for out of taxes they would frequently not be made at all.

Many capital expenditures are, however, incurred for non-self-supporting purposes. The funds, in other words, are spent for additions to the community plant or property from which no, or only little, money revenue is expected. The dividends are, in whole, or in part, of a non-material kind. Such expenditures may be further subdivided according as they are recurring or non-recurring. An example of the first kind is a schoolhouse. A schoolhouse represents an addition to the capital or permanent property of the community. Under the American system it is not used for purposes of revenue, as no fees are charged. In a growing city where population is continually increasing it is obvious that more schoolhouses will have to be built every few years and perhaps even annually. Since, therefore, the same capital expenditure will have to be made every year, or almost every year, it is proper that it should be paid for every year, or almost every year. In other words the cost of schoolhouses in a constantly growing community ought to be defrayed out of taxes on the pay-as-you-go principle. The situation is, however, different with the other class of non-self-supporting capital expenditures, namely, those of a non-recurring kind. Take, for instance, the purchase by the government of the telegraph or telephone system with the intention of so reducing charges as not even to meet running costs. Or, better still, take the building of a great art museum in a city or the purchase of a comprehensive system of parks. In the ordinary course of events a considerable period would elapse before another art museum or another such system of parks will be needed. Since the museum or park will continue to benefit the community as a whole for many years there is evidently an impropriety in putting the entire burden upon the taxpayers in any one year. To attempt to do this would not only be inequitable in itself, but would also defeat its purposes; for the larger the expenditure, the more disinclined would the taxpayers of any one year be to authorize the outlay. The probable result would be delay, or even complete failure, to authorize much needed improvements. In the case, therefore, of non-recurring, non-self-supporting capital expenditures the utilization of public credit is clearly permissible.

There is of course a border line or twilight zone where the arguments as between loans and taxes are rather evenly balanced. Take the New York court house problem as an example. It is difficult to say whether this ought to be called a recurring or a non-recurring expenditure. A new court house is indeed not needed every year. It is only a few decades, however, since the present court house was rebuilt. The same is true of bridges in a rapidly growing community. More than a certain number of bridges will probably not be required for a long time. But in the interval new or better bridges may be needed every few years. Where the opposing arguments are so close it is evidently desirable to defray the outlay partly out of loans and partly out of taxes.

Opposed to the capital expenditures of government are the current expenditures. These may be divided into ordinary and extraordinary expenditures. Ordinary expenditures are those which are incurred for the ordinary work of government from year to year as it may be anticipated and arranged for in the budget. As to these there is no question but that they should be met entirely out of the proceeds of taxes. One of the glaring abuses of the old Tammany régime in New York City was the way in which they kept the tax rate down by borrowing money for the ordinary current expenditures; as, for instance, the issue of twenty-year bonds for the purchase of brooms which lasted only a few months.

Extraordinary expenditures, on the other hand, are those which cannot well be foreseen or predicted with any reasonable accuracy; as the result of some unforeseen contingency they are out of the regular order, that is, they are extraordinary.

Extraordinary current expenditures may, however, like the capital expenditures mentioned above, be subdivided into recurring and non-recurring expenditures. A non-recurring extraordinary expenditure is typified in the case of the Chicago or the Boston fire. Since the outlay needed to keep these communities alive, or to repair the ravages of the conflagration, may not be expected ever to occur again, or certainly not for a long future, it would be manifestly improper to saddle the entire burden upon the unfortunate taxpayers of that particular year. The probability is that if any attempt were made to do so the needed repairs could not be made at all, or certainly not to the extent that would be appropriate. Of a similar character would be the extraordinary expenditures occa-

sioned by a great flood or famine in a country unaccustomed to such catastrophes.

On the other hand, there are certain classes of extraordinary expenditures the recurrence of which may be reasonably expected although the date of the recurrence is unknown. This would be the case with earthquakes in a country like Italy or famines in a country like India or tornados in some parts of the United States. In such cases it is entirely proper to accumulate out of the proceeds of taxation a fund which can ultimately be used for that purpose when the occasion arises. Since the contingency may occur at more or less periodic intervals it would manifestly be unwise to shift the burden upon the future; for before the future comes another contingency of the same kind may have occurred.

When finally we come to such expenditures as these of modern wars the question of exact classification is attended with considerable difficulty. It is indeed true that as long as human nature remains what it is and the fundamental causes of an economic and racial character are not removed, every nation must look forward to periodic outbreaks of this scourge. Certainly there is nothing to predispose us to the belief that the history of the world is to be so totally changed in the year 1917. In a certain sense, therefore, the extraordinary expenditures of a war may be put in the class of recurring expenditures. The recurrence, however, of such a gigantic war as the present world conflagration cannot be regarded as immediate. It is to be expected that it will take at least several decades for the various belligerents to recover from the strain and stress of the conflict. In the meantime, whether it be one decade or several decades that elapse, the benefits, such as they are, in any particular country necessarily attach to the intervening years. And at all events, it is not legitimate, even if there are no benefits at all, to put the entire burden upon those who happen to be taxpayers during the course of the war. When we speak of the distinction between the present and the future, it is not necessary to conceive of the future as the future generation or the future century. There are all manner of changes in the taxpaying abilities of the citizens within a century or even within a generation. And with reference to the particular circumstances of the present conflict, if this is a war to make democracy safe, it is certainly just that the coming

decades which will enjoy the benefits of security should bear some part of the cost of preserving it.

The conclusion, therefore, would be that in the case of a great war it would meet all the demands of justice to put part of the burden upon the present taxpayers and to shift the remainder upon the taxpayers of succeeding years with the understanding that all the charges of the war will finally have been met before the period when the recurrence of a similar outbreak is within the realm of probability. This conclusion in other words shows the essential legitimacy of utilizing both loans and taxes in times of war.

IV. The Disadvantages of Loans

The net gain involved in public credit may be impaired or even converted into a loss in three ways: (1) if exclusive use is made of public credit; (2) if the system of taxation after the war is materially changed to the disadvantage of the community; (3) if public credit is so abused as to lead to serious inflation. Let us consider each of these in turn:

1. All credit rests on a substratum of cash. Private credit is an adjunct of capital but it must depend on capital. The loans that a bank can make ought never exceed a certain percentage of the reserves. The volume of credit can always be greater than the amount of the cash reserve; but it cannot safely be independent of that amount. In the same way the attempt to finance a gigantic war entirely by loans without any solid basis of taxation would also represent unsound finance. The resulting loss of confidence would manifest itself in a depreciation of successive issues of government bonds and would ultimately cause embarrassment or disaster. But just as a bank may issue several dollars of credit for one dollar of cash, so a government may borrow for war purposes considerably more than it raises by taxation with equal advantage to all concerned. To finance a war entirely by loans is inadvisable; to finance a war in large measure by loans is legitimate. Employed in moderation and based on a solid foundation of largely increased war taxation, war loans are advantageous in reducing war costs. But the foundation of taxation must support the edifice of loans. Unless taxes are levied to an amount at least necessary to provide for the interest on the new loan, as well as for a reasonable amortization

quota or additional sums calculated to sink the debt within a reasonable period, the advantages of war loans will disappear. This is the serious danger to which some of the belligerents, like France, Russia and Germany, have already succumbed in the present conflict.

2. If taxes during the war were to be raised entirely from those best able to pay, and if the tax system were to be so altered after the war as to bear with severity upon those less able to pay, the advantage of loans over taxes would be impaired. It might be claimed, for instance, that the ordinary system of taxation in peace time is influenced so largely by the richer classes that wealth escapes its share. As the result of a war, however, the wealthier classes will become more patriotic and will be more ready to contribute. Even if this should not be the case, the very immensity of the sums to be raised, it might be said, will make it impossible to secure what is needed from taxes on general consumption and will necessitate resort to taxes on wealth. To raise any part of war expenditures, therefore, by loans instead of by taxes simply means that the less affluent classes will ultimately have to pay more. This involves a serious social maladjustment.

It may be questioned, however, whether such an argument is not in reality illicit. For we have here a comparison not between loans and taxes but between two different systems of taxation.[3] It is conceded that if taxation after the war could be based upon the same general principles as taxation during the war, the entire argument would fall away.[4] But this, we are told, is exceedingly unlikely. The enthusiasm engendered by the war, which will make

[3] Professor Pigou, for instance, with whom this whole argument originated, does not compare taxes in general with loans in general, but taxes on the wealthy with taxes on the poor. "Under the tax method the rich and moderately rich really shoulder the whole burden of the charge that is laid upon them. Under the loan method they do not do this, because they are compensated afterwards through taxes laid for that purpose, partly on themselves, but partly on other and poorer sections of the community." *The Economy and Finance of the War*, by A. C. Pigou, 1916, p. 70.

[4] Professor Durand, for instance, tells us "If we could assure ourselves that the distribution of taxes after the war would be as the distribution of taxes during the war, there would be little choice between taxation and borrowing." *Financial Mobilization for War*, papers presented at the Joint Conference of the Western Economic Society and the City Club of Chicago, June 21 and 22, 1917, p. 18.

the wealthy willing to pay greater taxes, will subside after the war.[5]

The retort, however, at once presents itself: what if peace taxes should be better than war taxes? It might plausibly be argued that during the enthusiasm engendered by a war the great mass of the people, and not only the very rich, might be willing to endure extra burdens; whereas after the return of peace they would insist upon a more equitable distribution of the burden. As a matter of fact the fiscal history of our own Civil War would tend to bear out this theory. The tax system during the Civil War was composed to an overwhelming extent of burdensome taxes on the great mass of the community. The income tax, for instance, was slight as compared with the tax on manufactured articles. After the return of peace, on the other hand, these burdensome taxes were removed one by one and the income tax was among the very last to disappear. Instead of the tax system after the war becoming progressively worse or more unjust, it became progressively better, or less unjust. The same thing is true of the fiscal history of other wars.

In truth, however, such an interpretation would be just as invalid as the preceding one. There is no necessary nor probable tendency in the one direction or in the other. Some systems of war taxation have been better, and some have been worse, than corresponding systems of peace taxation. There is nothing in the nature of war or peace which will fundamentally affect the situation. No one class in the community has a monopoly of loyalty. History does not show that the rich are more patriotic than the poor. The real forces which make for more equitable taxation are the growing democratization of the community with an increasing realization of the principles of justice. Modern systems of taxation, in war as in peace, are everywhere more equitable than former systems because of the gradual prevalence of these two factors. There is no warrant for the assumption that the return of peace will check this progress of democratization. There is no adequate foundation for the belief that in a democracy the fundamental causes which make for justice

[5] Professor Durand bases his whole argument on the assumption that the post-war taxes would be less equitable than the war taxes. He concedes that "this is not a necessary result," but he believes that "the great political power of the well-to-do classes would almost certainly enable them, if they sought to do so, to shift part of the burden on the poorer classes, and they would probably seek to do so." *Op. cit.*, p. 26.

in taxation will be less strong in peace than in war. A faulty analysis of the history of taxation and of democratic progress is not a sufficiently firm basis on which to predicate the inferiority of loans.

3. The third disadvantage of loans is alleged to be the tendency to inflation. As to the dangers and shortcomings of inflation, the burdens of which are borne in large part by the less affluent classes, it is unnecessary to speak. That loans may possibly lead to inflation is undoubted; that loans necessarily lead to inflation or that they lead to more inflation than would be brought about by other methods of securing revenue, is quite another matter.

To what extent can it be said that loans lead to inflation? In the case of foreign loans the question can of course not arise so far as the home country is concerned. Domestic loans, however, may be derived from five sources:

(a) From the liquid or free loanable capital in existence. Large sums, the results of previous accumulation, are always found ready for investment in the financial centers. In the United States these are to a great extent loaned on the stock exchange and used for purposes of speculation.[6] The transfer of these funds from the stock exchange to the government will assuredly not lead to inflation. Rather, the contrary would be the case.

(b) From the surplus of current production. The annual surplus products of a community are ordinarily converted into productive capital through new investment. If these investments are turned into the channel of government bonds instead of industrials there is no tendency to inflation.

(c) From a change of investment. If investors are tempted to sell their foreign securities and to buy government bonds there is again no tendency to inflation. If they sell their domestic industrial securities in order to invest in government bonds, there will even be a tendency to the contrary. For the throwing of so many domestic securities on the market will tend to reduce their value—leading to lower, rather than higher, prices.

(d) From anticipated savings. Many a citizen of moderate means will invest in war bonds paying for them by the fractional certificates which he laboriously purchases out of the savings due to decreased consumption or increased production. This will not lead to inflation, but to the reverse.

[6] Professor Durand's criticism, *op. cit.*, p. 16, overlooks this important fact.

(e) From borrowing at the bank. It is only in this single case when the investor pays for his war bonds by borrowing from the bank, or when the bank itself subscribes to the war, that the undue extension of credit by the bank may lead to inflation. But, in weighing the probabilities, it must be remembered that this is unsound banking, and that every effort will be made to avoid it in a reformed system like the present. As a matter of fact we know that the banks have been urged to make only short-time advances on the new war loan. Moreover, even if this were not the case, the extension of credit to the bondholders would necessitate a partial withdrawal, at least, of credit facilities to the ordinary business enterprises, so that the inflation would be less than it really seems.

What we are considering, however, is primarily not whether loans cause inflation, but whether inflation is due to loans or whether there is anything peculiarly distinctive about loans in causing inflation. These considerations have almost entirely been overlooked in the discussion.

In the first place, there is no doubt that wars are always attended by inflation. But this inflation would ensue entirely apart from loans. The chief factors which explain the rise of prices during a war are the vastly augmented demands of the government, the dislocation of production coupled with the falling off in the social output, and the augmented supply of the currency. These are the fundamental causes which make for inflation and they will exert their effect irrespective of the choice between loans and taxes.

In the second place, it is a fallacy to suppose that if loans lead to inflation taxes will prevent inflation. Modern war taxes are to an overwhelming extent levied on business. The distinguishing features of our present system, for instance, are the high corporate income and excess-profits taxes. It is familiar to those acquainted with business conditions that many corporations whose profits are largely on paper, whose resources are heavily engaged, and who are anxious to utilize their profits in extending their operations, are even now preparing to borrow on a large scale from the banks or to issue short-time notes in order to pay their taxes. Were the war to be financed entirely, or to a large extent, by taxes instead of by loans, this resort to bank credit on the part of prudently managed enterprises would be still further emphasized. There is consequently less difference than is commonly supposed between a resort to loans

and a resort to taxes. Some of the funds may be borrowed from the banks in each case; and it is by no means certain that the borrowing is likely to be far more marked in the case of great loans than in the case of very high taxation.[7]

Finally it must not be forgotten that if there were no loans, or even insignificant loans, the tax system would, in all probability, not only be excessive in its burdensomeness, but, as we shall see, inadequate in its yield. With a failure of war taxation to defray expenditures the ultimate resort would then necessarily be to fiat money or inconvertible paper, which, as everyone concedes, would cause far greater inflation than anything else. Thus the failure to resort to loans in proper amount would almost inevitably, in a protracted contest, lead to the worst possible kind of inflation.

Is it not clear then that the relation between loans and inflation must not be exaggerated? Loans may indeed lead to inflation, but so may taxes lead to inflation; inflation is due primarily to other and more fundamental causes then either loans or taxes; and the attempt to avoid inflation by abandoning the use of loans will almost inevitably lead to far greater inflation in the end.

If, then, there is little reason for anticipating (1) any serious abuse of public credit, or (2) a fundamental and unfortunate change in the tax system after the war, or (3) any undue or peculiar tendency to inflation as a result of loans, it follows that a proper use of public credit may be of net advantage to society.

V. THE ADVANTAGES AND DISADVANTAGES OF TAXES

Up to this point we have adverted to the advantages and disadvantages of loans and by implication have considered some of the advantages and disadvantages of taxation. It may conduce, however, to clarity of exposition to marshal here some of the arguments which refer particularly to taxes.

The first advantage of war taxation is its effect upon consumption. As we pointed out at the beginning, the important point in the economic life of a community at war, as at peace, is to have

[7] It is significant that Professor Pigou, who was the first to put forward the inflation theory in war finance, is careful not to limit this probable eventuality to loans. He tells us explicitly: "If, as is probable in the case of very large levies, their (the rich) borrowings for war loans and war taxes exceed their normal borrowings in times of peace, there is likely to occur a certain amount of currency inflation." *Op. cit.*, p. 76.

a surplus of current production. This surplus must be measured in terms not simply of material output, but also of subjective sacrifices. The outstanding fact in every great war is the sudden and sharp reduction in production. Unless the consumption of the community keeps this slower pace the result will be disastrous. For although the community can rely to a certain extent upon the accumulations of the past and can also, as we have pointed out, defer some of the sacrifice to the future, a large part of the burden must be borne at present. The current consumption of the community must be cut down to the measure of the current production if there is to be any surplus.

The advantage of high war taxes is that they may help to bring about this result. But while this is true, the effects of taxation on consumption must not be exaggerated. In the first place taxation is not alone in affecting consumption. Consumption may be influenced by legislative prohibition and by rationing. In truth, during the present war, these factors have been of much greater influence than taxation. In the second place taxes are not the only fiscal expedient which can affect consumption. One of the chief points in the recent issues of war loans, here as abroad, has been the appeal to patriotism and the facilities afforded for investment in the loans, to be made good by current savings. It is true that taxes involve a compulsory, and loans only a voluntary, appeal to saving. But it would be a mistake to overestimate the influence of the former and to underestimate that of the latter in reducing consumption.

In the third place the beneficial effects of taxes upon consumption may be seriously exaggerated. If, as is true, war taxes largely assume the form of taxes on business enterprises and corporations, there will be almost no influence upon consumption; and the little influence exerted on consumption may be outweighed by the possible injurious effects on production, thus reducing instead of enlarging the social surplus. Moreover, even as far as individual income taxes are concerned, the results are by no means certain. On large and very large incomes the tax is not apt to be paid out of current income at all. The ordinary man of wealth will be much more likely to draw temporarily upon his capital during the war than to reduce his personal expenditures. Again, while it is true that very high taxes on small or moderate incomes will check consumption the danger is that we shall cause not only sacrifices, but

real privation, the disadvantages of which may counterbalance the advantages of a reduced consumption.

While, therefore, high war taxes may tend in part to reduce consumption, the effects and beneficial consequences can easily be exaggerated.

The second advantage of high war taxes is that the actual burden in times of war is really less than it appears to be. A war gives unusual opportunities to make immense gains and the profits secured by the war contracts are apt to be more or less widely diffused throughout the community in the form of high wages and general business prosperity. It is for this reason that the tax on war profits, or on excess profits, has everywhere become a fundamental feature in the tax program. In the second place the higher price level due to the inflation that always accompanies a war makes a given tax a much smaller relative burden. And, thirdly, it is more economical to levy high taxes during a war when the diversion of current income to ordinary investment of capital is relatively small than to postpone the tax until a time when the need of capital investment will again become acute.

These are the undoubted advantages of high taxes. But over against the advantages must be set the disadvantages.

The first drawback is the inadequacy of taxation during a war. The protagonists of high taxation seem to think that the entire or well nigh the entire expenditures of a war may be met with taxation.[8]

Even a superficial glance at the facts ought to show the baselessness of such an assumption. We do not venture to utilize here any figures as to national wealth or social income because of the worthlessness for scientific purposes of any such computations. But we should like to emphasize the fact that the limit of taxation is to be measured not by the social income, but by the social surplus, that is, the excess of the net income over the consumption of the members of society. This social surplus is very much less than is often represented. In England, for instance, where the tax on the moderate incomes has been raised to 25 per cent and on the larger incomes up to 42½ per cent, the net additional receipts from the income

[8] So, for instance, Professor Durand says: "If during the war itself highly progressive taxes were levied sufficient to meet the war expenditures," *op. cit.*, p. 26. The same thing is true of Professor Sprague and some other American writers. Professor Pigou, however, is much more cautious in simply advocating increased revenue from high taxation.

tax amount to about one billion dollars. Even if we assume that the recipients of moderate incomes could endure the privation of an additional 25 per cent of the income, thus doubling the returns; and if we further assume that on the higher grades it would be possible to confiscate the entire income beyond a small minimum, thus doubling or trebling the revenue, we should have as the conceivable maximum from the income tax in Great Britain between three and four billions of dollars. Again, if the excess-profits tax were increased from the present figure of eighty per cent, which yields about one billion dollars, so as to take in all of the profits, we would have another few hundred millions income. If, therefore, England were to tax the entire available social surplus through the highest possible income tax and excess-profits tax, the total revenue would be absurdly short of meeting the war expenditures which are already now over eleven billion dollars and which are gradually mounting. In order to meet even one-half of the war expenditures from taxation it would be necessary for Great Britain, in addition to confiscating incomes and profits, to impose immense burdens upon that part of accumulated wealth or property which is susceptible of sale abroad.

The figures *mutatis mutandis* would be similar in this country. In order to raise even one-half, not to speak of the total, of the nineteen billions required this year and of the still larger sums which may be needed as the war progresses, it would be necessary not only to take by taxation most of the smaller incomes and all of the higher incomes, but also to confiscate virtually all of business profits, and finally, after levying crushing taxes on consumption, to take such part of the existing private property of the United States as could find a ready market abroad. Even the mere statement of such a proposition carries its refutation on the face.

But if the inadequacy of sole reliance upon taxation is patent there are also well-founded objections to levying excessive taxes even short of this impossible total. Taxes may roughly be divided into taxes on wealth (income, property and inheritance taxes), taxes on business (taxes on profits, production and exchange), and taxes on consumption (import duties and excises).

The chief modern tax on wealth is the income tax. It is accordingly entirely proper that in time of war the principal reliance should be based on this source of revenue with a very much higher

graduated scale of progression on the larger incomes. But entirely apart from the extreme advocated by some of confiscating all incomes over $100,000[9] there are at least four dangers in excessive income taxes.

1. The administrative difficulties will be greatly increased. It is as true of the income tax as of the arithmetic of the customs that two and two do not always make four. Excessive import duties induce smuggling; excessive income taxes engender evasion. With such a delicately adjusted machinery as in the case of our income tax it is to be feared that excessively high rates will cause not only a disappointing yield but also an increasing inequality as between individual taxpayers.

2. If the rates are too high the tax may act like an excessive consumption tax and by pressing unduly upon the margin of comfortable existence cause great privation.

3. If levied chiefly upon the higher incomes it may seriously trench upon the sum ordinarily devoted to the educational, philanthropic and religious institutions and thus cause widespread injury to the immaterial interests of the community. This objection has only in part been removed by the recent amendment to our income tax law.

4. Excessive taxes on incomes will deplete the surplus available for investment and interfere with the placing of the enormous loans which will be necessary in any event. It might be replied to this last argument that the more you raise by taxes the less will have to be raised by loans. This does not, however, meet the point. For if the taxes are so high as to discourage industry they will obviously dry up the source of future incomes and thus deplete to that extent the surplus which would otherwise be available for future loans. Entirely apart from that fact, however, high taxes will interfere with loans in so far as the loans are financed even temporarily by the banks. If a would-be investor borrows from a bank, the amount of his credit will be in a certain proportion to his estimated profits. Every dollar's diminution of his prospective income will cause several dollars' decrease in the amount which he will think it prudent to

[9] This has been done by Professor Sprague in his address before the American Economic Association. *Papers and Proceedings of the Twenty-ninth Annual Meeting of the American Economic Association, December, 1916*, p. 211. Similar propositions were made in Congress.

borrow or which the bank will think it safe to lend. If, therefore, the income tax is so high as seriously to deplete his investing surplus, it will cause a far greater falling off in the amount which he can subscribe to the loan. It is significant that this is the chief argument that has weighed with the Chancellor of the Exchequer in England in refusing to increase English taxation.[10]

Excessive taxes on business again may have all manner of injurious consequences. Taxes on war profits are indeed not open to the same objections, but our tax on excess profits is far more than a tax on war profits. When they are too high, they tend to check the needed transfer of industry and of investment to war purposes just at the time when new enterprise is desperately needed. Although our tax can by no means yet be called excessive, it is well known that in several important cases it has already begun to exert such a repressive effect.

The evils of excessive taxes on exchange and consumption are so familiar that they need not be recounted here.

It will be seen, therefore, that the dangers of excessive taxes are not to be overlooked. The anti-social consequences of excessive taxation are perhaps more to be emphasized than the similar evils of excessive loans.

It is important, moreover, that the public mind should be informed not only as to the dangers of excessive taxation, but also as to the inevitable failure of exclusive reliance upon any single group of taxes. It would be in the highest degree unfortunate if through emphasis upon such slogans as "conscription of wealth" and the like, the general citizen body acquired the feeling that war taxation meant immunity for themselves. Just as the war from a military point of view can be won by putting forth the united efforts of the nation, so the war can be won from the fiscal point of view only by reliance upon the ability of the entire citizen body whether rich or poor.

[10] Mr. Bonar Law has stated this several times, the last time on August 13, 1917: "I quite admit that in financing the war the government has to get the largest amount out of taxation which is compatible with maintaining the financial security of the country; but I have said many times that there comes a limit at which if you keep on increasing taxation, you might give up all hope of raising money by loan. It is obvious that if you tax to such an extent as to destroy the financial position, you must abandon all hope of loans." *Parliamentary Debates*, vol. xcvii, p. 944, 945.

Let there be no misapprehension about the thesis of this paper. We are by no means opposed to high taxation. On the contrary we believe it is essentially sound finance to raise far larger sums from taxation in war than in peace. We have no lance to break for the exaggerated policy of France or of Germany. But in considering the limits of taxation one is apt to overlook obvious facts. In 1913–1914 Great Britain raised by taxation 163 million pounds; in 1916–1917 514 million or 351 million pounds additional, *i.e.*, about 215 per cent more. The United States raised by taxation in the four years 1912–1915 an average of 648 million dollars annually.[11] The War Revenue Act of 1917, which is expected to yield $2,510,000,000, increases the taxes by 387 per cent. What it really means to quadruple the burdens of taxation is not generally recognized by those who speak so glibly of defraying the entire expenditure of a war from taxation. That we have reached the limit, however, is by no means sure. The practical situation that confronts us is this. The additional war expenses this year will be about nineteen billions, of which about four billions are still to be provided. It is, in our opinion, entirely feasible to raise more money by taxation, perhaps another billion or one and one-half billions from the income tax, the excess-profits tax and new excise taxes. The time may even come when we shall have to secure a still further revenue from taxes on accumulated wealth. But even with all these resources it is indubitable that an important reliance will continue to be, as it ought to be, on loans. The enthusiastic plan, so hastily advanced by some American economists of financing the war "mainly, if not entirely" from taxation, and even the fifty-fifty per cent program originally advanced by the executive, are so far beyond the practicable or economically defensible that they may safely be neglected.

VI. CONCLUSIONS

The conclusions from the above analysis are as follows:

1. Government loans are indispensable to a sound war finance. If properly used, they tend to lighten the burden of a war.

[11]

1912	$632 millions
1913	662 millions
1914	672 millions
1915	629 millions

2. To attempt to finance a war exclusively through loans is short-sighted.

3. To attempt to finance a war exclusively through taxes is suicidal.

4. War taxes should be large and immediate, but should never be stretched beyond the point where they begin to lessen the social output, to hamper the transfer of pre-war to war production, or to press unduly on desirable consumption.

5. War taxes must be high enough to assure a solid foundation for the loans and to ensure a rapid payment of the debt within a relatively short time.

6. At the outbreak of a war, and during the early period, very much greater sums ought to be raised by loans than by taxes.

7. As the war proceeds a continuously larger amount can and should be raised by taxation, although at no time will the government be free from the necessity of relying to a considerable extent upon the use of public credit.

In the Civil War, as in some of the belligerent countries today, it is undoubted that too little was raised by taxes. At present it is probable that even England could safely raise somewhat more than the existing 17 or 20 per cent of war expenses by taxation. We could profitably go somewhat higher. But between the 25 or 35 per cent, which even we have not yet begun to reach, and the 80 or 100 per cent which has seriously been suggested in this country, there is an immense chasm. Let us, indeed, be careful to avoid the dangers to which France and Germany have succumbed, but let us not be led by a faulty analysis or a misplaced enthusiasm into the devious by-paths of unsound finance and of hazardous economics.

THE RELATIONSHIP BETWEEN LOANS AND TAXES IN WAR FINANCE

By Oliver M. W. Sprague, Ph.D.,
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I shall discuss the relationship between loans and taxes in war finance solely with reference to the present case of the United States. I shall also assume that the people are prepared to adopt that financial policy, however burdensome it may be, which will enable us at the earliest possible moment to place an adequately equipped army in the field and sustain our allies with abundant supplies of food and military material. That this is a well-founded assumption general acquiescence in the selective draft affords convincing evidence. This policy, however strongly advocated by military experts, would hardly have been adopted if the experience of other countries during the present war had not made clear to the ordinary layman that it was the wise course to follow. Similarly, I feel certain that if the people become convinced that a particular method of financing the war—financing it mainly by taxation, for example—would contribute to the speedy and effective mobilization of the economic forces of the country for war purposes, they would adopt that policy in the same spirit which they have manifested toward the conscription of men for military service.

On the other hand, if it makes no particular difference in the conduct of the war whether the bulk of the funds is secured through loans or taxes, if it is a purely financial question, it is altogether unlikely that the people would be ready to meet by taxation a large proportion of the cost of the war. Revenue from taxation during the war, slightly exceeding the amount which will be needed in subsequent years of peace to meet ordinary expenditures and debt charges, would be the policy which almost certainly would be adopted. On purely financial grounds, the amount of taxation during the war should be somewhat greater than in the following years of peace since patriotic fervor lightens the burden upon the taxpayer, and during the continuance of a war business is somewhat more active than during a series of years good and bad in times of

peace. The special profits reaped by those engaged in industries stimulated by war are also a proper field for special taxation of the English excess profits variety.

The equities of the situation as between those who serve with the colors and those who remain at home would justify placing the entire burden of financing a war upon those who remain at home, but this in itself is not a consideration which can be relied upon to develop general willingness to make the sacrifice which the policy of taxation would impose upon the community. But suppose the people become convinced that the amount of taxation levied during the war has an important bearing upon the speed and effectiveness of our preparations for the conflict. Under present arrangements, four billion dollars of our estimated expenditure during the current fiscal year are to be derived from taxation and fifteen billion dollars from loans. It is quite possible that this is a wise proportion, but if it were clear that some other proportion would better serve the purpose in view, is it to be doubted that the people would favor its adoption? The proper, and also the feasible relation between loans and taxes in war finance is surely that proportion which will most speedily bring about the mobilization of our economic forces for the effective prosecution of the war.

Without prejudging the question, and simply as a concrete method of approach, I am going to contrast the situation as it is and may be expected to develop under the financial arrangements which have been authorized, with the situation which might be expected to develop if the proportions between loans and taxes had been reversed, and fifteen billion dollars were to be raised through taxation and only four billion dollars by means of loans.

In one very fundamental respect the two policies would have similar consequences. The expenditure of nineteen billion dollars means at the present level of prices the employment of something like a third of the capital and labor of the country in providing goods and services for the government. There will consequently not be enough labor and capital available to produce the customary quantity of goods and services for civilian consumption and for the usual annual additions to the capital equipment of the country. This radical, and one is tempted to say ruthless, change in the relative proportions between individual and national consumption will also be accompanied by very great changes in the quantities of

the various things to be consumed. Some things will be wanted in much greater quantities, while in the case of others the demand will be greatly reduced. Those engaged in industries, the demand for the products of which is stimulated by the war, will prosper, and labor and capital must be transferred to them from other industries which must necessarily become less than normally active. This transition from a peace to a war basis is necessarily a painful process to many engaged in well-established and prosperous businesses and to their employes. There is a natural inclination to make the change slowly, with the least possible disturbance and loss to those concerned. But what if military exigencies will brook no delay? Clearly this is our present situation. There is urgent need for the production of more food, ships and military material of all sorts. No sacrifice is too great which will accelerate and increase the production of these vitally important commodities. Unhappily, the process of transition from a peace to a war footing is proceeding slowly with consequent danger of increasing the loss of life at the front, the prolongation of the war, and in the last analysis, increasing the money cost of the conflict. Supplies of efficient labor and of material for the war industries are not being enlarged to anything like the maximum possible extent. The fundamental cause of this unsatisfactory situation is not far to seek. It is because the demand for labor and materials continues intense in industries, the products of which are valueless for war purposes.

If the policy of financing the war mainly by means of taxes had been adopted, the civilian demand for the products of all our industries would have been greatly diminished. Owners would have been eager to convert their equipment to war uses, and much labor would have been eager for employment in the war industries. It is the fundamental defect of the loan policy in the present emergency that it exerts a far less effective influence in these directions. The loan policy would be quite as effective if all subscribers to liberty bonds made payment entirely from current income saved while the proceeds of each loan were being expended by the government. In this event the civilian demand for goods and services would decline roughly in proportion to the increased government demand. A large part of the funds secured through war loans does, of course, represent current savings, but a very considerable part consists of borrowings from banks involving the expansion of bank credit.

There is an increase in the total amount of purchasing power with no corresponding increase in the volume of goods offered for sale. The civilian demand for goods is consequently not directly reduced by the full amount of the loans. People endeavor to maintain their accustomed scale of expenditure though it is manifestly impossible. The attempt is frustrated by the rise of prices. The expenditure of a given sum of money procures the proceeds of the employment of smaller and smaller amounts of labor and capital.

The rise of prices which results from the loan policy of war finance is of course particularly burdensome to persons in receipt of stationary incomes and adds greatly to the money costs of a war. But these are minor defects in comparison with the check which it places upon the rapid mobilization of the labor and capital of the country for war. The continued civilian demand only slightly checked by exhortations to economy deludes producers into the belief that business can continue as usual for a long time, if not during the entire course of a great war. They continue to buy materials, retain their labor force by the offer of higher wages, and endeavor, often with entire success, to produce accustomed supplies of goods, regardless of their utility for military purposes. So far as materials are concerned, the government, or those having government contracts, may meet the situation by the offer of higher and higher prices, and where this course is only partially successful, may resort to the commandeering of essential products. As to labor, the offer of higher wages is not a sufficient means of securing an adequate and efficient supply and commandeering is out of the question. When steady employment at rising wages is offered at home, it is hardly to be expected that workmen will flock to the centers where war industries flourish. Moreover, the abnormally high wages that are offered all too frequently seem to be accompanied by, if not to occasion, a positive loss in efficiency. To sum up, although the total output of industry is now perhaps greater than ever before, the proportion of it which is of military value is far less than is urgently needed, and far less than its possible maximum.

As evidence of the large possibilities of securing additional labor and materials for war purposes, a few concrete examples of conditions in particular industries and occupations will perhaps be helpful. Consider first the case of the pleasure automobile. There has been little if any diminution of the consumption of gasoline, and

very few chauffeurs have been dispensed with. Chauffeurs as a class have mechanical instincts and many possess not a little mechanical skill. All of them could be usefully employed in connection with our shipbuilding program or in allied occupations. This is not a question to be determined by the ability of the employer to pay the wages of the chauffeur. The country needs the discontinuance of such use of this part of its limited supply of labor. In any event it will be discontinued in the course of time. Far more progress would already have been made in this direction if the War Revenue Act recently passed by Congress had included a tax of $10 a month rising by stages to $50 a month after next March on all employers of chauffeurs for other than commercial or professional purposes. A heavy tax on gasoline used in running pleasure cars would also be serviceable here and at the same time effect a desirable economy among those who drive their own cars.

Turning next to the sugar industry we find that manufacturers of candy and soda fountain syrups have been running full blast all summer, while economy in the household use of sugar has been urged and in some measure practiced. Subjected recently to temporary curtailment of production and threatened by the necessity of closing down permanently, manufacturers have protested on the ground that thousands would be thrown out of work—this at a time when even were sugar as plentiful as sand, it may well be doubted whether these businesses should continue at the pre-war level of production. A heavy tax on candy and syrups would have conserved the supply of sugar and might also have led to a gradual contraction in production, rather than the sudden cessation of operations which now threatens. In this instance, the loan policy cannot even be credited with bringing about that gradual transfer from a peace to a war footing which is so desirable when it does not interfere with military preparations.

Consider next the wool situation. Apparently the government will require practically all the available supply, yet having civilian orders on hand, the mills have not yet begun to curtail operations. Curtailment of production will apparently come in a series of jolts and perhaps with a crash. Had very much heavier income taxes been imposed the civilian demand for cloth would have been materially restricted. Mills would probably have gradually curtailed the scale of their operations relieving the labor market in some measure and conserving the supply of wool.

Finally consider the case of coal. Production is on a greater scale than ever before, yet the supply is inadequate and its movement taxes our transportation facilities. Price fixation is a further complication. The situation is so intolerable that the Priority Board will probably be forced to take drastic action limiting or cutting off altogether consumption in industries which are valueless for military purposes. By this method it will accomplish something which might have been brought about in a far more gradual fashion by taxation which would have placed a check upon individual consumption, and consequently the demand for coal in civilian industries.

When subjected to the test of contributing to a maximum of military preparation in the shortest possible time, the revenue measure recently passed by Congress leaves much to be desired. In making this statement it is proper to add that it should not be taken as a criticism of the patriotic and generally speaking wise work of the members of the committees which framed the measure. The possibilities of taxation as a means of hastening effective military preparation have never, so far as I am aware, been given thorough-going consideration. Another war revenue measure must, however, be framed in the near future, and so it will perhaps be worth while to consider with this object in view some of the modifications which may well be made in the present law.

The very heavy rates of taxation imposed upon large incomes are entirely proper upon purely financial grounds; they have, however, little or no significance with regard to military preparation, since the money taken by the tax gatherer from such persons would in almost every instance have been invested, most of it no doubt in liberty bonds. The more moderate rates on incomes of less than say $100,000 are quite as likely to occasion a reduction in the accustomed amount of savings as in consumption. A tax of twenty-five per cent, as in England, on entire incomes of $12,500 with suitable super-taxes on income in excess of that amount would be financially desirable and might also be expected to bring about not a little curtailment in the consumption of goods by individuals. But income taxes alone would not accomplish the end in view. The expense and administrative difficulties of the tax forbid its application to the great mass of people. They, and in fact the entire community, can be reached by taxes on consumption, and it is consump-

tion that must in some way be checked either by the unsatisfactory method of rising prices alone, or by a combination of rising prices and of taxation. Every commodity or service in connection with which much labor and material valuable for military purposes are employed would be a proper subject for taxation at the present time. We as a people are in the situation of an athletic team training for a contest. But there are so many of us that we lack the compelling unifying influence which is present in a small group working for a common purpose. Through taxation we can gain this unifying influence. It is, for example, not difficult to convince most men that their chauffeurs might be more usefully employed, but for any one individual to act in the matter would obviously amount to so little that he ordinarily does nothing. Let virtually everyone dispense with chauffeurs and the value of the proceeding as a whole would lighten the feeling of deprivation to each individual. Again, in the case of sugar we might tax all sugar, or since a part of it is a necessary food, we might tax only the articles of luxury in the production of which it is an important constituent. A tax of twenty-five per cent or even fifty per cent on the retail price of candy would conserve sugar by bringing about a reduction in one of its relatively unimportant uses.

Many other commodities and services should also be taxed, but these instances will sufficiently illustrate the two advantages which may be gained. In some cases, a tax on tea for example, revenue would be the primary object, in others, as the tax on chauffeurs, the setting free of labor or conserving materials for war uses.

Of course the burden of heavy consumption taxes would fall unequally upon different people and classes. The same statement may be made regarding the effects of the rapid rise of prices occasioned when wars are financed by loans. It may, however, be urged that people endure the burden which comes upon them from rising prices very much in the same resigned fashion that they accept the infirmities of old age, while analogous burdens due to specific taxes might occasion serious discontent. I should feel inclined to agree, but at the same time I should add that I feel even more certain that if the people are convinced that heavy consumption taxes would contribute to preparation for the war and hasten its speedy conclusion, they would not flinch from the burden.

SHIFTING THE WAR BURDEN UPON THE FUTURE

By Roy G. Blakey, Ph.D.,
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Congress has already appropriated nearly nineteen billion dollars for expenditures of the current fiscal year which ends June 30 next. In addition, it has authorized contracts of over two and a half billions for which it has not yet made appropriations. Part, though not all, of the money will be needed on these contracts this year, so that our total expenditures in round numbers will be twenty or twenty-one billions if no more are authorized. Our federal revenue laws have been revised recently so as to raise about three and three-fourths billions through taxes. If they are not further revised, this will leave sixteen or seventeen billions to be raised through loans, or a ratio of loans to taxes of about four and one-half to one. We have already subscribed about six billions in loans so we still have to secure about ten or eleven billions in loans and nearly all of the taxes. This means that about fourteen billions, or two-thirds of the total amount necessary, are yet to be secured after payment of subscriptions to the current bond issue.

It is extremely difficult for us to appreciate what it means to raise twenty-one billion dollars in a single year. This is over twenty-five times our ordinary federal expenditures prior to the war, it is twenty times our national debt of a year ago, it is over seven times our national debt at the end of the Civil War, and it is over four times the combined cost of all of our five wars beginning with the Revolution. Furthermore, it is more than all of the Entente Allies spent in either the first or second year of the war, it is four-fifths as much as Great Britain, the largest spender, has used in three entire years, and it is two-thirds of the combined expenditures of all the central powers in the same three-year period.

But these stupendous figures do not become real to us unless we consider them in terms of the sacrifice which they will mean. The most accurate estimate of the national income of this country puts it at about thirty billions in 1910. The most recent estimates are based upon this, and, after allowing for the increase in prices and

for increased production due to more general employment, greater population, speeding up, etc., they put the present national income at forty-five to fifty billions. Our present plans call for a diversion of over two-fifths of this amount to war purposes. To put it in another way, the twenty-one billions mean an average of $200 for every man, woman and child, or $1,000 for every family of five in the United States. Reduced to these terms, we can begin to visualize what a tremendous burden this involves, though few of us can comprehend that it is really to fall upon ourselves.

Although many have not thought of the burden in very concrete terms, some others have realized that twenty billions is an enormous sum to raise and that taxes twenty-five times as heavy as heretofore would be very grievous; hence many plans have been suggested to obviate the use of such taxes and to avoid or lighten the burden through borrowing. There are few fallacies so plausible and yet so harmful and general throughout the land as those involved in the idea that we can shift the larger part of the burden of this war to the future by substituting loans for taxes. One reason that this idea is so harmful is that it contains all the evils of a half truth; another and most important reason is that we are confused with money and monetary terms so that we do not see clearly the real things for which money stands.

When we stop to think we know that it is not twenty-one billions of dollars which our government wants ultimately, but twenty-one billion dollars worth of commodities and services. Our national income does not consist of forty-five or fifty billions of dollars of gold, silver and paper, but of that many dollars worth of wheat, lumber, minerals, clothing, automobiles, etc. There are less than five billions of actual gold, silver and paper dollars in existence in the United States. These dollars are the counters in terms of which the real things are measured and by means of which they are exchanged more easily. For our present purposes to have gold, or silver, or paper is not to have anything of value in itself, but merely to have a claim upon real things for which it can be exchanged. It is obvious that our government needs money in order that it may exchange it for men and commodities, for it is with these that it must fight the German military forces. It is obvious, also, that it must have these men and commodities now. Munitions of 1930 and men not yet born cannot be hurled against the enemy's lines. The burden of

furnishing all of these things must be assumed now, it cannot be put off till the future.

If we could borrow from other nations, we might fight the war with what they loaned to us and we ourselves go ahead consuming what we produce, as we have been doing before the war. In that case, we could shift the paying of them, that is, the burden of the war, to the future. But there are no other nations who can lend to us at this time; we ourselves must raise an army, equip it and keep it supplied. Not only must all of this be done at home, but in addition, we must help to feed and equip our allies. None of this can be left to the future.

Of course the next generation will be injured because of this war. Billions of dollars worth of labor and food and steel and other materials that are now absolutely destroyed in war are diverted from the construction of railroads, irrigation systems, manufacturing plants, improved roads, houses, all of which might have aided our descendants and made their lives fuller and happier. If a man's property is destroyed his children receive an impaired heritage, both he and they suffer. Our descendants must suffer in this fashion because much of their patrimony is being destroyed. But we cannot, as a nation, postpone our burden if we would, nor can the future help us. Then why delude ourselves with thinking that it can?

But while it is impossible for this nation to shift part of the burden to the future, it is possible for certain individuals and classes to shift parts of their shares on to other individuals or classes, both now and in the future. This is true whether all of the means to prosecute the war are secured through loans or taxes, or both. Let us consider the two means of taxes and loans, respectively. Realizing that everything needed must be secured now, everyone will concede that each individual should pay his just share. This will mean a much greater part of large incomes than of small ones, but we shall not here go into details of exactly what constitutes a just share. We merely assume that each should pay his just share when what is just has been determined.

We may assume first that each individual pays his share in the form of taxes. These taxes might be paid in money or in kind. In either case, what the payer gives up and what the government gets ultimately is services and commodities. For this payment, the government gives the payer a tax receipt. Suppose on the other

hand that each individual gives up to the government his just share in the form of a loan. This is exactly the same amount as we supposed in the first case that he gave up in taxes. In this case, as in the other, it may be in money or in kind, and, similarly as in that case, he really gives up and the government gets services and commodities. The only difference in the two cases is that in the first one he has a tax receipt and in the second he has a government bond, a promise that he shall be paid back with interest.

But let us consider the paying back process. If the future taxes are levied justly, each one (or his heirs) will be taxed just enough to pay his own bond and whatever interest it draws. That is, he merely transfers money from one pocket to another and his bond is paid. When he lent to the government and thought he was better off than if he had paid taxes, he deluded himself.

It is obvious that if anyone pays less than his just share, someone else must pay more. But when a war comes unexpectedly it may find many individuals unprepared to pay their just shares of a new and large burden. It may be best all around to permit some to assume the burden of others temporarily, either wholly or in part. This may be done whether the government supplies its needs through loans or through taxes. Because this is so apparent in the case of government loans, we shall consider only the case of taxes. Assume that the government is to secure everything through taxes. Assume two men of equal ability to pay taxes. At the time the war burden comes A has a large shoe plant turning out thousands of pairs daily. B has a smaller plant, but he is building a large additional one to construct which he is borrowing, besides turning into it all the proceeds from his existing plant. Let us assume that neither has other liabilities or assets. It is obvious that A can use his proceeds above living expenses, either to pay taxes or to buy bonds. The amount thus available for government use is probably greater than his share of the government requirements, at least, he probably can make it greater by reducing his ordinary consumption of luxuries and near luxuries. But it is not so convenient for B to pay taxes. The only way he can do so is to give up his new plant which would involve great loss, or to borrow more. He ought to be able to borrow and A is in a position to lend to him. That is, A advances B's taxes, and later, when B's larger plant is turning out its full quota and his debt for construction is paid off, he concludes the transaction by paying

his debt to A. In other words, for the time being, B shifted his tax burden to A and later B repaid A with interest and each profited by the transaction.

In this last assumption, the government secured everything through taxation, nothing through loans. But this same thing might have been accomplished through government loans. Assume again A and B as in the last case. The government offers a bond issue. A is in a position to buy bonds, but B is not. In buying more than his share of bonds, A is really lending, through government agency, to B, who is not now in a position to buy his share. Now observe the process of paying off these bonds. Though A and B were equally able when the war came on, B is now more able to pay taxes because A has lent the proceeds of his plant while B has not only loaned but has put his proceeds into a bigger plant so that he now has more property and a greater output than A. Both A and B must pay taxes to redeem the bonds. If the burden is distributed equitably on the basis of our former assumption, A's taxes will be enough to pay himself, not all the government owes him, but just the amount which would have been his just share of taxes plus interest on the same, if he had paid taxes in the first place instead of buying bonds. B's taxes will pay the rest due A and they will be the exact amount which B would have paid in taxes plus interest, had he paid taxes in the first place instead of letting A buy bonds equal to the share of both. In so far as the government can make easier advantageous credit transactions by itself assuming the borrowing agency instead of leaving the transactions to be arranged between individuals, there is a further net gain. This is the real essential economic justification of government loans.

We shall take up later some of the offsetting losses occasioned by the borrowing plan. But before we go further, we should note again that whether the government supplies its needs through taxes and thus necessitates private borrowing, or whether the government itself does the borrowing, the shifting of the burden is not from the present to the future so far as the nation as a whole is concerned. All the shifting now and in the future is between individuals. If there were no offsetting losses the total net burden would probably be a little less in the present because of the government loans but the national burden of the future would hardly be affected one way

or the other. It would be merely a matter between individuals; what was given up in taxes by certain persons would be received by part of themselves in payment of bonds and interest. It is conceivable that this redistribution of income might be either advantageous or disadvantageous from a national standpoint.

This point may be made more vivid if we consider the case of Germany who has been unable to borrow much from outside her own borders. Because of this fact many said at the beginning that Germany could not last long. But she has demonstrated that she is a powerful enemy with an unconquerable fighting machine just so long as she can provide men and materials. Having mere gold and silver is a secondary matter, but having the necessities of war when needed rather than in the future has been her chief strength. True, she has floated huge internal loans but that has not postponed the national burden of carrying on the war, it has merely been a shift between various citizens of the empire as becomes obvious if we consider what would happen if the internal debt were repudiated later. In such a case the taxpayers would retain the money which would otherwise be transferred from them to those who owned bonds. In so far as the taxpayers and bondholders are identical, the transfer of money would be first to the government and then back to the individual. Of course, the same reasoning applies to the United States.

The advantages of accommodation which government loans permit are very great in the beginning of a war when readjustments are being made and while a new tax system is being made productive as Professor Adams[1] points out. Later they lose much of this advantage and they involve certain important disadvantages as compared with taxes. One of the most important of these disadvantages is that the burden of taxation is apt to be distributed more equitably if the taxes are levied during the war than if after its close. The well-to-do classes have practically always controlled legislation directly or indirectly and they are much more likely to be willing to assume their just burdens during the war while the spirit of patriotism is almost universal and while others are giving their lives to the country. After the war closes they are much more apt to resort to indirect taxes which fall upon people in proportion to what they consume rather than in proportion to their ability to pay.

[1] See pages 28–30.

In this connection I should call attention to Professor Seligman's[2] statement that the experience of the Civil War showed that the reverse is the case. It is true, as he stated, that many of the excise taxes were repealed before the income tax which fell more heavily upon the well-to-do. But the significant fact which he did not mention is that the high tariff duties, which during the war were merely compensatory, were retained for half a century after the war and during all of that time formed the bulwark of federal revenues as well as a source of privilege to the industrial entrepreneurs. Few warnings of the Civil War are more important in the present case than that suggested by this experience. In the violent readjustments which the close of the war will necessitate, we are almost sure to have a widespread demand for protectionism and the revenue needs of the government are apt to be used as a strong argument for this form of subsidy to the few at the expense of the many. Hence, there is a triple reason for high taxes during the war: first, the patriotic call which will mean more equitable distribution then than later; second, high prices during the war which cut down the standard of living of the masses but bring greater profits to the employers of labor and the large scale producers and sellers of war necessities, thus enabling them to pay high taxes; third, the demoralization of readjustment following the war which will bring an immense decline in profits and ability to pay excess profits and other taxes and which will at the same time cause great numbers of soldiers, munition makers and others to be taken off of the government payrolls and put upon those of readjusted private industries.

A still further and indeed the most important advantage of taxes over loans is that, if levied properly, they are much more likely to cause everybody to economize in accordance with his ability to do so. If one has to pay $100 or $1,000 in taxes, he is much more apt to economize immediately than if he lends that much to the government thinking that he has an investment which will not only bring interest but which will be paid back later. He forgets, or never realizes, that he may have to repay himself later, and hence is inclined to save less than if he had made a gift or paid a tax to the government. Furthermore, he knows that if he has unexpected financial needs in the future he can sell his bond and get his money back, or that he can borrow on it at the bank, so there is not the

[2] See page 72.

necessity for him to economize as in the case of taxes. We shall attempt to show a little later the extreme necessity of widespread and stringent economy.

All economists, including the few who advocate a large proportion of loans as compared with taxes, as well as the many who advocate the reverse proportion, agree that the borrowing of money from the banks to buy bonds, or the borrowing upon bonds as collateral, or the purchase of bonds by the banks is certain to cause inflation. Furthermore, all agree that this inflation, by causing a rapid rise in prices, injures very seriously nearly all wage-earners, salaried employes and all receivers of relatively fixed incomes, but benefits those who pay these wages and other relatively fixed incomes, and especially those who have large quantities of commodities to sell. In other words, inflation means a redistribution of income and property, mostly in favor of the active business class and to the misfortune of the large laboring class. But the details of inflation, how it is brought about and how it works, I shall leave for others to discuss. Suffice it to say that the evils are extremely great as our own experience in the Civil and Revolutionary Wars and as experience in scores of other cases has abundantly proved.

The idea that we can put off a large part of the war burden till the future and the policy of huge loans and inadequate taxes which it encourages are largely responsible for our failure to economize now as we should. As already mentioned heavy taxes would immediately bring home to us the necessity of economy. But as it is, many still continue to preach "business as usual" and many others think the war can be financed by some sort of financial legerdemain. They do not begin to realize the extent of the sacrifice which it means.

Let us recall that after allowing for speeding up, increased population, more general employment, higher prices, etc., the best estimates of our national income place it at forty-five to fifty billion dollars, and that Congress has authorized expenditures of two-fifths of this income for war purposes this year. Let us recall, too, that this income and these expenditures are not dollars but that they are real commodities and services. The government cannot by any financial hocus-pocus get twenty billions worth of commodities and services unless we give up that amount and live on the remainder. If business continues as usual, it means that we demand the same

necessaries and luxuries as before, that the same men and farms and manufacturing plants are necessary to produce these goods as before and that the government can secure nobody to fight in its armies or to make ships, munitions and other extraordinary things needed to carry on a war. It is possible to carry on a huge extra undertaking like the war only by diverting a large part of our energies from the usual channels. Everyone who does not save, who still demands the same goods as formerly, prevents the labor which produces what he consumes from being diverted to government use. Those who give up luxuries and near luxuries permit the labor and materials and plant used in their production to be diverted to making necessities of life and munitions and other commodities needed to supply the military forces. We have already shown that this diversion must take place now, to put it off till the future means to lose the war. If any person does not do his share of saving, someone else must save more. But laboring under the delusion that this burden may be shifted in large part to the future, very few of us have begun to economize to the extent of two-fifths of our income, which is the average amount that must be saved to carry out present plans.

It is estimated that heretofore we have been saving five or six billion dollars annually and with it constructing new capital in the form of additional railroad, irrigation, manufacturing and other plant. If all of this construction could be and were stopped and the labor and commodities which have hitherto gone into it were turned to direct war purposes, we would have to reduce our ordinary consumption by only fifteen billion instead of by twenty or twenty-one billion, that is, by only a third instead of by two-fifths.

But it will be said that not everyone can reduce his consumption by a third. This is true of the masses with small incomes, but it is not true as many seem to think, that the rich can bear all or nearly all of the burden of twenty billions a year. Their total income does not amount to that sum. Dr. E. Dana Durand, than whom there is no more competent authority in the United States, has calculated that only one-tenth of the entire national income is received by those having incomes in excess of $25,000. In order to secure two-fifths of the total national income it would be necessary to take 100 per cent of all of the family incomes in excess of $1,500. Even if allowances are made for recent changes in American incomes, it is apparent that the rich alone cannot finance the war. While it

is true that they can make much the largest contributions per family and even in proportion to their total incomes, still it is necessary that all classes shall economize.

Besides the misconceptions mentioned above, there are many others current throughout the country. Among them we shall take time to mention only a few of the most popular and plausible ones. We are told upon all hands that, of the twenty-one billions, seven billions are not our own expense but are for loans to the allies. So far as the war period is concerned, these loans are to all intents and purposes our own expense. Like ourselves, the allies want and must have commodities, not gold and silver, and we can furnish these to them only by doing without them ourselves.

In connection with our loans to the allies there is another common fallacy in the implied advantages which we are to receive because all of these loans will be spent in this country. It is true that this will mean more work and a greater demand for our commodities and this is probably a good reason why those who are thus specially benefited should subscribe more liberally for bonds. But for the nation as a whole this is not an advantage but a distinct disadvantage. We do not at the present need more work, rather we need more help to perform the enormous tasks before us. The pity is that the allies and ourselves cannot spend this money to advantage in other countries so that we might have that much additional aid in overcoming the common enemy.

Another misconception is common among those who urge the withdrawal of savings bank deposits to buy bonds as well as among those who urge insurance and other investing companies to accept government bonds in payment of premiums. To withdraw savings from a bank means that the bank must withdraw loans to others; to pay life insurance premiums with bonds means almost the same thing. Unless these and similar transactions cause the party at one end or the other to cut down his consumption in order to replace amounts thus withdrawn, no service has been done the national cause. To thus economize is just what the man who uses bonds to pay life insurance premiums or other obligations is not likely to do. It is because he doesn't want to make the extra sacrifice that he wants the privilege of using bonds as money. Of course, to borrow from a commercial bank to buy bonds is one of the quickest methods of causing inflation. The same result happens if the bank itself

buys bonds. With 4 per cent interest on government bonds, and even higher rates probable if the war continues much longer, there will be a terrible strain upon savings banks. The recent bond issue is causing a large withdrawal of savings deposits and banks themselves are subscribing to the bonds to prevent even greater withdrawals. As time goes on this is apt to become worse instead of better and with it inflation will grow apace.

If the reduction of consumption by two-fifths or a third of what we have been used to could be quickly brought about voluntarily or by a proper system of taxation, we could finance the war, that is, secure the men and commodities with which to prosecute it, without any process of inflation. But when these commodities and services cannot be gotten by voluntary saving and when there is too much objection to adequate taxation, then the government must resort to borrowing. If this is done upon a large scale, as in the present war, the banks are gradually forced to lend directly or indirectly and also to buy bonds themselves, in order that bond issues may not fail and that the government can get what it needs. Mr. Schiff[3] openly advocates this increase of credit by the pyramiding of deposits, because, as he states, the people cannot or will not save enough.

But the heaviest taxes that are likely to be adopted will not prevent the consumption of many luxuries and near luxuries. Let us take one example. Even though it does have an effect, the present tax of 3 per cent, or even a tax of 25 per cent, on pleasure cars will not prevent many from being bought, although reduced incomes will have more effect. All unnecessary demand for such luxuries keeps from the army needed men and munitions. Why should not the government decide as in the case of coal, sugar and other commodities, who has a legitimate need for automobiles in war times and absolutely prohibit others from buying them? Many other similar examples suggest themselves to everyone. We might well go much further than we have in this direction; ordinary economic forces usually work fairly well in the long run, but they are too slow in many cases in an emergency like the present. Of course we would not disregard entirely the cautions given by Prof. H. C. Adams.[4]

Inasmuch as the problems of proper taxation are discussed

[3] See page 49.
[4] See page 28.

more at length elsewhere, we shall not go into details here, but we will call attention to the many cries that heavy taxation will hurt business, dry up the source of revenue and even cut down production at the time when it is most needed. This is a very serious matter in some of its aspects, and much care should be taken in levying proper taxation. Our present excess profits tax is far from perfect and has many wrinkles which need ironing out. But most of those who criticize heavy taxes upon business do so almost indiscriminately. It is unfortunate to hurt any business man or employe, but it is for the national good, in fact, absolutely essential, that unnecessary production should cease and that those engaged in such should go into the military service, or furnish supplies for the military, or do the work of others that the latter may help the government. The adjustment is painful and it should be handled with discretion but it should be forced. Those industries which minister to war needs will have such greatly increased demands that there is little danger that they will be taxed to death. Of course, such taxation is theoretically possible, but taxation which leaves 10 per cent or more net profit should not discourage the investment of capital in these lines nor the largest possible output, if the entrepreneurs of America have the least spark of unselfish patriotism. It would be all the more desirable to invest in these industries if others less useful were taxed more heavily. Existing tax measures intend to leave most of our war industries a much larger net profit than 10 per cent, though it is true that many difficulties, and particularly the matter of obsolescence, must be worked out.

We would not deny the function of credit which Professor Seligman[5] emphasizes so much, in fact, we have already illustrated its advantages under certain conditions, but we think he lays too much stress upon subjective as opposed to objective costs. Where what is borrowed is destroyed as in this war, we think it important that people realize what are the objective costs, and that such a realization will have an effect upon subjective costs. If people are ignorant the immediate subjective costs of indirect taxation may be less than half that amount of direct taxation. But if they appreciate the facts, the subjective costs of the two taxes will be reversed and society will be better off for the change. Bond issues which cause inflation really amount to unduly heavy indirect taxes upon

[5] See page 58 *ff*.

the masses, not in accordance with their ability to pay, but in proportion to their expenditures. It is important that both financiers and the masses realize this fact so that subjective costs shall harmonize with the public welfare.

In concluding let me give two homely illustrations of the main points which I have been trying to emphasize. The United States is so large that we cannot see it as a unit, hence let us consider a ranch or a plantation which is more or less isolated and self-sufficient. The father and his sons, perhaps the families of several sons, besides many helpers, are actively engaged in producing a living for the group. After the necessities are provided for, some can devote themselves to producing comforts and even luxuries. Suppose the neighboring ranches or plantations are beset by a powerful enemy and this ranch goes to their rescue. Would anybody argue that they can put off any of the war burdens till the future? Or would anybody urge that those who were making candy or silk dresses or pleasure cars, or other unnecessary things, should continue as usual? Would not all energies be directed to the most direct war purposes, and would not everyone reduce his demand for luxuries, and even for ordinary necessities as much as possible?

To take the second illustration. Let us look at our national income of 1910 as 30,000,000,000 gallons of milk instead of that many dollars worth of commodities and services. Suppose an increase of five or ten billions up to 1917, due to actual increased production, and a still further increase to forty-five or fifty billions due to pouring in of water. Suppose at this time a war makes it necessary that the government have twenty billions of this total of fifty billions. The government may take different methods to secure this amount. It may get it by taxing or by borrowing. If these methods cause a corresponding reduction in consumption of milk, this can be accomplished successfully, but if one method, say borrowing, caused a dilution of the milk, difficulty arises. If such evasion of economy is attempted, the government is forced to pour in water or to have others pour in water for it. By pouring in thirty or thirty-five billions of gallons there is made a total of eighty or eighty-five billions. The government can then take out thirty or thirty-five billions and get twenty billions of real milk and the public can have left for civil needs fifty billion gallons of what it calls milk but which is really very much less. A reduction of consumption has thus been forced,

not by taxes but by inflation. Those who received a stated income still receive the same number of gallons (or dollars) or even possibly somewhat more, but the food value (or purchasing power) is much lessened.

These two illustrations bring home three important points: first, that the burden of the war cannot possibly be put off till the future; second, that the burden is enormous and inevitable and cannot be met by any financial makeshift, but demands unusual and stringent economy; and third, that attempts to shirk economy through excessive loans will not make the burden less but will distribute it much more inequitably.

As we have intimated above, the fundamental thing in our war finance is the stimulation of production for war which is possible only through reduction of consumption. This reduction is even more important practically than a total increased production, because it has much greater possibilities within a short time. If we will cease to delude ourselves about the possibility of shifting a large part of the immense burden upon the future, or of avoiding it in other impossible ways, and really recognize the task as it is and undertake to grapple with it, we can avoid some of the terrible mistakes of the past. This means that we should now raise larger amounts by taxation, and that an even greater proportion should be so raised hereafter as industry becomes more adjusted to the changed conditions. Furthermore, economies should be forced by governmental suspension of unnecessary production.

The present limit to taxation is psychological. That limit may well be pushed much further if there can be a general appreciation of the real ways in which the war may be financed. The danger is that in trying to escape the discomforts of the great economies which are absolutely necessary, we shall, through excessive borrowing, throw an increasing amount of the financing upon the banks. There is little likelihood that the government will use paper money; that has been too much discredited. While that method might have been resorted to in Civil War and previous times when note issue banking was common, in the present the much more subtle and effective method is through the pyramiding of deposits, as actually advocated by Mr. Schiff.[6] By trying to escape thus, the nation shall not escape, but shall be forced to even greater sacrifices. In

[6] See page 49.

fact, it shall force its masses, who can least afford to economize, to a greatly reduced consumption through a further decreased purchasing power of the money medium.

To thus secure the reduction necessary to win the war through inflation is most inequitable and probably the most disastrous method in the long run. "To make the world safe for democracy" is flaunted upon our banners. It is a worthy battle cry in our supreme struggle with Prussian autocracy. But in the adaptation of means to ends it should not be disregarded at home at the fountain head of democracy.

DO GOVERNMENT LOANS CAUSE INFLATION?

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In the cynicism born of world collapse, George Brandes has lately revived an epigram imputed to Frederick the Great: "I begin by taking. Then I always find men of science to prove the justice of my claim." There is danger of scholarship becoming thus "official" in a democracy no less than in an absolutism. Public passion cracks as sharp a whip as any despot, and the applause of the market-place is as grave a menace to independent thought as the favor of the throne.

In public finance, war or peace, the treasury is always beset by two opposed forces. On the one hand, there is opportunism and practicability—opportunism in using the stress of war need to accomplish ends in doubt; practicability in meeting the fiscal strain with least trouble and dislike. On the other hand is economic theory and fiscal law—rugged and dure, straight and narrow, serving the public need with measures conceived solely with respect to fiscal principle, and hewing to this line even with struggle in making and difficulty in carrying out.

Certainly no budget has ever been wholly the one thing or the other—utterly neutral in convenience nor wholly virginal in theory. Even a time-serving finance minister must occasionally relapse into science without knowing it, and the scholar enthroned in the exchequer cannot have all literally as his text-books set forth. But the varying degree of emphasis is sufficient difference. In the one case convenience is the end in view with theoretical excellence a by-product; in the other, fiscal theory holds mitigated by practical concession.

The rôle of the student critic called to pass judgment upon these alternate policies is at least in one respect plain. He should insist that each policy stand firmly on its own merit, and that if non-fiscal considerations are to affect the course this should be clearly set forth. Most of all, should he resent the use of bad scientific reasoning in praise of one procedure or in blame of the other.

A glaring instance of this misuse is the outright resistance to funding in war finance on the score that it makes inevitably for inflation and thus for high prices—or more briefly the inflation argument against war loans. Both as a melancholy example of scientific lapse, and as a mischief-making error in the actual conduct of war finance, it has seemed worth while to examine this claim.

It is possible to trace with some exactness the growth of the doctrine. Without returning to shadowy beginnings, the first explicit phrasing of the argument appears to have been made in 1915–1916 by an English economist of note, Mr. A. C. Pigou, professor of political economy in the University of Cambridge in two public lectures delivered in Cambridge, in articles contributed to the *Contemporary Review* and, more formally, in a little book on "The Economy and Finance of the War."

The preface of Pigou's book is dated October, 1916. In December, 1916, at the meeting of the American Economic Association held in Columbus, Ohio, an eminent American economist, Professor O. M. W. Sprague of Harvard University, presented a paper on "Loans and Taxes in War Finance" wherein, quite independent of Pigou's exposition, the inflationist argument against funding, foreshadowed in certain of the speaker's earlier writings, was set forth with detail and vigor. Admitting that "it is not absolutely inevitable that war finance based on borrowing should cause a general rise in prices," Professor Sprague noted that "It is significant, however, that whenever governments have resorted to this policy prices generally have manifested marked and continued upward tendency."

Professor Pigou's and Professor Sprague's views, spoken with some measure of scientific restraint, were received with attention, if not assent, within expert circles. They were given circulation and vogue by the Minnesota "memorial of American economists to Congress regarding war finance," an attempt to determine congressional action upon the then pending war revenue bill by arraying the body of academic economists in support of such propositions as:

> It may be necessary for a month or two at the outset to issue a limited amount of bonds, pending the collection of increased taxes, but beyond these, which might well be made repayable within a year, no necessity for bonds exists.

Thus far the inflationist doctrine had circulated as an academic hypothesis. In April, 1917, it was unexpectedly translated into the

higher altitude of state policy by a sentence of President Wilson's message to the special session of Congress:

> It is our duty, I most respectfully urge, to protect our people so far as we may against the very serious hardships and evils which would be likely to arise out of the inflation which would be produced by vast loans.

II

The inflationist argument has been too often set forth to need restatement here. Its drift will be recalled by the summary of a competent student, Professor Sprague:

> Many subscribers [to the loans] borrow from the banks the funds required to meet their commitments, pledging other property and even the war loan itself. The banks adopt a liberal patriotic loan policy and also subscribe largely on their own account. These transactions, the borrowing from banks and the investments by banks, occasion expansion in the volume of credit, both in the form of bank notes and of deposits, and are the most potent single cause of the general advance in prices during periods of war.

If we follow the first impulse of the scientist and turn from outright hypothesis to attempted proof, the inflationist contention encounters rough sledding. No one has to my knowledge suggested that verification be found in past war financing, nor is there likely to be such claim. For even remotely parallel conditions we should be obliged to turn to the two great wars of the past hundred years—the Napoleonic struggle and our own Civil War—and here the relative crudity of banking operations in the one case and the all-eclipsing effect of fiat issues in the other put any kind of helpful comparison out of question. Such warrant as may be found for the doctrine is to be sought in the fiscal developments of the past three years—in the longer experience of Great Britain, in the more recent history of the United States.

As far as Great Britain is concerned, there has been an extraordinary rise in general prices and there have been extensive funding operations. The *Economist* index number which in August, 1914, stood at 2698 had risen in August, 1915, to 3296, in August, 1916, to 4372, and in August, 1917, to 5658—a relative change of 110 per cent. As to funding operations, the net borrowings including loans to allies and dominions, from August 1, 1914, to August 25, 1917, were roughly twenty billion dollars as compared with somewhat more than six billion dollars raised by revenue.

But the English situation has been affected by the issue of treasury notes "to a much greater extent than was required to take the place of the gold which has been called in from circulation" and by a great increase in the coinage of silver. Moreover, English borrowings are an intricate complex of war loans, treasury bills, exchequer bonds, war savings certificates and bank credits against ways and means advances.

During the past months there has raged in English financial circles, technical and academic, a controversy recalling in variety and intensity the classic bullion debate of a century ago, as to whether inflation really existed in England, whether it was imputable, wholly or in any part, to public borrowing, and whether this consequence, if existent, was avoidable or inevitable. The result has been, if not to leave the main issue in doubt, at least to make it impossible in our present knowledge to determine the respective contribution of the several factors involved.

In the United States we have witnessed a hardly less sensational rise in prices, the Department of Labor index number of wholesale prices standing at 100 in 1916 as compared with 81 in 1915 and 80 in 1914 and advancing thereafter to 139 in April, 1917. But during this period the country was still in neutral state, and there was no resort to large scale borrowing. There were extensive purchases of obligations of foreign governments; but these were not remotely in excess of the new domestic capital issues that more normal conditions might have been expected to induce. If any closer connection between funding and inflation be sought, it appears that the period of war loans, dating from the first liberty loan, was a period of continuing rising prices, the Department of Labor index number of wholesale prices advancing from 139 in April, to 149 in May, to 150 in June; but that the percentage of increase was not sensationally more rapid than in the preceding period.

Returning then from unsuccessful induction to cautious analysis, it appears that inflation may conceivably but need not inevitably result from funding operations. The actual process has been subject to searching examination by Professor William A. Scott, and the conclusions therein reached are likely to represent the present consensus of deliberate economic opinion: To the extent that bonds are bought, ultimately, from uninvested capital, from current income, from liquidated investments, or from future savings there can be no

inflation. To the extent that bonds are bought by banks for their own account by credit creation, or by individuals through bank loans or are thereafter hypothecated for such loans, and partake of the nature of long time engagements rather than of installment purchases—inflation may result. The actual proportion of such non-inflating "savings" purchases to the class of potentially inflating "credit" purchases is, in the war-funding experience of the United States, undetermined. But whatever it be, there is no fixity attached thereto and financial policy exercised through banking control can reduce to the degree of virtual elimination the relative and even the absolute importance of credit purchases.

In the far less guarded form in which it has circulated in the United States, the inflation argument represents not the use of wrong theory, but the abuse of a right one. It is reminiscent of Elia's injunction to eschew roast pig lest conflagrations be encouraged, or a later counsel to travel on foot because badly driven horses will sometimes shy. That an unwisely directed borrowing policy may take the form of "credit" loans rather than of "savings" loans is no reason why borrowing as a measure of war finance should be denounced lock, stock and barrel as inflationist in effect. The obvious alternative is, having first determined to what extent recourse shall or must be had to loans in a war programme, to plan such operations to tap the fund of present and the source of future savings.

III

The inflationist controversy, aside from the rather sorry rôle which expert economic opinion has played therein, points two lessons: (1) The danger of belaboring loans as an unsound method of war finance in view of the fiscal validity or, waiving any discussion, the practical necessity of recourse thereto. (2) The importance in a funding policy of distinguishing between "credit" loans and "savings" loans, of stimulating "savings" loans by appropriate devices, and of discouraging large resort to "credit" loans.

As to the first: The inflationist argument may conceivably have served some purpose in dispelling the illusion that the war could be financed without material increase in taxation. By specifying and emphasizing a danger that attends funding, the public mind may have become reconciled to new and drastic tax

burdens. But a disingenuous logic will inevitably rise to plague the state that uses it, in finance as in legislation.

Is it fanciful to assume that some considerable part of the difficulty we have experienced in arousing the great body of American citizens to the life and death necessity of continuous and universal loan subscription is due to the lethargy, even tacit hostility, in the public mind engendered by the denunciation of public borrowing as a vicious mode of financing the war? Such terms as "the conscription of capital," degenerating into outright epithets, such as "the slacker's theory of war finance," employed by Professor Carver, may have seemed of tactical advantage in aiding the enactment of heavy income and profits taxation. But we should impute a very short memory and a very faulty logic to the popular mind were we to assume that when, a few months later, the liberty loan campaigns were launched there was not a traceable consequence of public indifference or even indisposition.

As to the second: The importance of distinguishing between credit loans and savings loans, of discouraging the one and stimulating the other—there has been an impressive because unconscious development in the United States in even the short six months' interval between the first and the second liberty loans. We entered upon our war loan financing in much the manner of our infrequent peace loan operations, with the expectation of large corporate purchases and incidental regard to general popular absorption. We emerged from that trying experience—perhaps wiser, certainly chastened—with the realization that there was a limit marked by investment resources beyond which corporate purchases could be pushed only at the expense of credit expansion and that, on the other hand, there was a vast untouched fund in the form of the current and prospective savings of the great body of producers of the nation from which funded loans might be drawn.

The second liberty loan campaign has been waged with this distinction grown clearer and clearer. Before it had ended "save and pay" had become a slogan almost in replacement of the older "borrow and buy," and the nation may be said to have fairly awakened to the realization that the ultimate source of a national loan is the unspent income of its producers. It is an exhibit of the financial genius of the country, and a tribute to the sanity of its financial leadership that the banking organizations of the country re-

sponded, not, it is true, with equal effectiveness but on the whole with remarkable adaptability, to this new policy.

Much too remains to be done, but the vista is far from depressing. A nation to small extent accustomed to save, and to negligent extent accustomed to place these savings in funded form, to whom a government bond has been as comprehensible but as unaccustomed an acquisition as, let us say, an aeroplane or an adding machine, has taken its first step, and a large and true one at that, in the direction in which we must learn to walk if the war is to be financed with greatest efficiency and least hardship.

In the discipline that lies ahead there must be universal part. It will not be enough to preach to the great body of wage-earners restraint in individual expenditure and diversion of income—whether accruing from increased productivity or heightened abstinence—to the public treasury through the instrumentality of periodic funding, continuous borrowing or war savings certificates. A like denial must show itself in every quarter. Public bodies, states, counties, cities and preëminently the federal government, must postpone contemplated, even suspend actual projects of public improvement, commendable in ordinary times but now perilous in their additional requisition upon the capital supply and the labor force of the nation. Industrial and mercantile establishments, where not under the whip and spur of war production, must exercise caution in applying the gains of enterprise to enlargement of plant and join the queue of lenders. Almost all the financial institutions of the land, both by individual initiative and through centralized leadership, must embody in outright banking practice the doctrine of economic restraint.

For this is the alternative we confront: Not the fantastic possibility of financing the war without resort to loans; but the choice of a manner of borrowing on the one hand, which will supply the nation's needs from the savings of its citizenry, with a heritage of new thrift and restrained expenditure, and, on the other hand, a mode of forced loan effected through the unchecked expansion of banking credit with its mischief-making trail of inflation and depreciation. Only an unintelligent fatalism will leave the issue uncertain.

Note.—Since the foregoing was written, there have been im-

portant developments in our financial policy. The Treasury has made large use of certificates of indebtedness in anticipation of revenue from loans and taxes, and the issue of war savings certificates for popular absorption has been vigorously begun. The bearing of these devices, notably of the certificates of indebtedness, upon the matter of inflation is an extremely difficult problem, certain aspects of which the present writer has undertaken in another connection to discuss. It is also interesting to note that the Comptroller of the Currency has wisely arranged that the forthcoming report of the conditions of the national banks, as of November 20, 1917, should make available certain much needed data as to subsciptions by and through banks to the second liberty loan, and as to the amount and quality of loans made by the banks on the security of liberty loan bonds.—*J. H. H.*

WAR FINANCE AND INFLATION

By A. C. Miller,
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The beginning of wisdom in the financing of our war is the full appreciation of the fact that the ultimate term in our war finance must be not money, not the dollar—but what the dollar will buy. Every day that the war goes on makes it clearer and clearer that the war is a contest in economic organization and resources, and that victory will lie with the nations which show themselves best able to organize their resources and to resist the processes of economic waste and disintegration. Indeed, it looks as though the war would not end until all the economic power of America is developed to its highest pitch of efficiency and then delivered as gun-power on the far flung battle fronts of Europe. We are all rapidly coming to understand that great belligerent nations must be organized from the fighting line back to the field, factory and foundry, as great fighting machines, as great organizations for converting the productive-power, the saving-power and the will-power of the people at home into fighting-power at the front. We are also coming to understand that the winning of the war presents a problem of economic strategy as well as of military strategy: the two together constituting the essential elements of an adequate war strategy. Our economic strategy must work hand in hand with our military strategy if we are to make ourselves most effective in coördinating our own activities, and those of the other nations forming the grand alliance, into one great whole so as to bring the war to an early and victorious conclusion. Many are the contributions which time and circumstance will show America must make toward the successful completion of the war, but there is none perhaps that in the end will prove more important than that of developing and supplying leadership and mastery in coördinating the activities of herself and her associates along the larger lines of economic and military strategy.

The financial problem in its larger aspects, as I conceive it, is largely one of developing a plan under which the instrumentalities of finance may be so employed as to enforce a sound, and in the end, a triumphant economic strategy.

I

Some such thought as this, I believe, was in the mind of the President when he made the momentous observations on war economy and finance contained in his message of April 2. Properly understood, they are more than observations: they are the basic principles of national finance for our guidance in this great crisis. The President, calling upon Congress and the country to "exert all its power and employ all its resources to bring the government of the German Empire to terms and end the war," states what this will involve in the way of economic and financial preparation in these propositions:

> It will involve the organization and mobilization of all the material resources of the country to supply the materials of war and serve the incidental needs of the nation in the most abundant and yet the most economical and efficient way possible.
>
> It will involve, also, of course, the granting of adequate credits to the government, sustained, I hope, so far as they can equitably be sustained by the present generation, by well-conceived taxation.
>
> I say sustained so far as may be equitable by taxation, because it seems to me that it would be most unwise to base the credits, which will now be necessary, entirely on money borrowed. It is our duty, I most respectfully urge, to protect our people, so far as we may, against the very serious hardships and evils which would be likely to arise out of the inflation which would be produced by vast loans.

Supplementing these statements in his Proclamation on War Economies, which was issued less than two weeks after the war message was delivered to Congress, the President concludes one of the most trenchant economic surveys that has ever come from the pen of statesman or scholar with these pregnant words:

> This is the time for America to correct her unpardonable fault of wastefulness and extravagance. Let every man and every woman assume the duty of careful, provident use and expenditure as a public duty, as a dictate of patriotism which no one can now expect ever to be excused or forgiven for ignoring.

Briefly summarizing the economic and financial principles laid down by the President, I would state them as follows:

(1) Organization and mobilization of all the country's material resources;

(2) Strict economy through saving;

(3) Well-conceived taxation;

(4) Avoidance of inflation.

The rule of finanee they suggest to my mind for the conduct of the war, I venture to formulate as follows: *Taxation should be carried to the point where the remainder of the needed income of the government can safely be provided out of the proceeds of loans—that is, be provided without producing inflation of credit and prices.* The clear inference I draw is that sound finance will require that the limits of taxation should be extended as borrowing reaches the point of inflation. Hardly less clear to my mind and certainly not less cogent is the inference that finance alone will not achieve the needed results: consumption will have to be controlled and production will have to be directed on some adequate basis, in order that any plan of finance we may adopt shall be certainly equal to the task of providing the government with the vast masses of goods and services it will require for the war.

II

The present war differs from preceding wars in many ways but in none more than in the prodigious quantities of material supplies of many sorts which are required. It is this circumstance which gives to its financial problems their peculiar difficulty and urgency. No satisfactory progress can be made toward a solution of those problems if close calculation is not made at every point of what is involved in the way of surrender for war purposes of the customary consumption and income of the country. I venture, therefore, some statements—not on my own authority, but on the authority of men who have given much thought to the matter—touching some of the underlying facts bearing upon the economic costs of the war in terms of the man-power it will require.

We are setting out to provide, equip and maintain an army of a million men. Competent judgment has estimated that it will take the labor of four men, working in munition factories, clothing factories, on the farm and the transportation systems of the country, to maintain one soldier at the front according to modern standards of military efficiency. This means that an American army of one million men will require the output of four million men working in factory, field and foundry. If the war should go on into a second year and we undertake to organize and maintain at the front an army of two million men, the ratio will still hold good: we shall require an industrial army of eight million men working at home to

maintain, provision and equip those fighting at the front. But our part in the war, it is well known, is not only to maintain our own quota of the necessary fighting forces, but also to help the great nations with which we are associated to maintain their quotas and, in addition, supply their civilian populations with a large part of their necessary maintenance. Europe is now on rations and an important part of our work in furthering the war is to supply the nations, with which we are allied, with the primary necessities to the utmost extent we can. There is competent authority for the statement that the munitions, provisions and other maintenance which the armies and civilian populations of our allies should have from us will require the output of more than ten million laborers working in their behalf in this country.

If these estimates are approximately accurate and we can make our predications on the assumption that we are to maintain an army of but one million men, requiring as has been pointed out the labor force of four million men at home, and bearing in mind that the million men composing the army are themselves withdrawn for the most part from productive industry, it is clear that the undertaking involves the devotion to war purposes, directly or indirectly, of the services and product of approximately fifteen million men here in America on the farm, in the shipyard or in the factory. If we accept as approximately accurate the estimate of our present available labor supply as amounting to thirty million workers, the magnitude of the economic problem with which we are confronted, is suggested by the statement that not less than one-half of our existing labor supply, during the period of the war, must be devoted to the producing of materials and supplies to be consumed by our own army and the armies of our allies and the civilian populations of the nations in Europe which are dependent on us for a part of their necessary keep. This means that the civilian population of our own country will have to rearrange its mode of living so as to be able to get along with the product of the remaining labor power of the country—that is, about one-half of what has been customary—unless happily the labor forces of the country can be effectively recruited and augmented by the introduction of men and women into industry who are not now to be reckoned among the productive classes of the community. We can do this if we will, and it is doubtful whether we can win the war, or at any rate

win it as quickly and decisively as we all desire, unless we raise our will-power to the point where we will do it.

This, in sum and in its simplest terms, is the economic problem to which we must address ourselves. The financial problem is the problem of getting control of the products needed by the government by the methods which are least wasteful, least obstructive and least subversive.

III

On its financial side, the magnitude of the obligation we have assumed is indicated by the nineteen billions of dollars which Congress has authorized to be used for the general purposes of the war for the fiscal year ending June 1918, including in this total the credits granted to the Allies. Never has any nation, either in the present or any other war, undertaken so vast a pecuniary obligation for the same period of time. We are undertaking to apply to the support of the war in a single year almost as much as the German Empire has spent since the beginning of the war.

Can we provide for the vast expenditure we have undertaken? What have we, as a nation, got in the way of the requisite financial resources to offset the nineteen billions Congress has voted?

It must be clear to any one who gives any serious attention to the financing of the war that the expenditures of the government must, except for a negligible proportion, be defrayed out of the *income* of the community. The limits, moreover, within which any part of the burden of our war costs can be shifted to posterity are so narrow, especially for a country in our position with no outside markets left from which to borrow, that we must regard the burden as one that has got to be shouldered and paid for as we go along out of the product of our current national industry—or, putting it in the more familiar financial term, out of the people's current income.

Unfortunately no official or authoritative estimate of the current annual income of the people of the nation has been made, so far as I am aware. Some widely used estimates made at the time of our entry into the war placed the annual money income of the nation at forty billions of dollars or thereabouts. Such information and data as I have been able to obtain and such investigation as I have been able to make, lead me, however, to believe that this is a very considerable under-statement of our actual situation. Using

the term "income" as substantially identical with the money value of the gross annual product of the country's industrial and business activities, I believe there is warrant for the opinion that the industrial and business income of the people of the United States for the year 1917 may come close to fifty billions of dollars: the following estimate in summary form containing the data on which this opinion is based:

SUMMARY ESTIMATE OF THE TOTAL VALUE OF THE NATIONAL PRODUCT AND PRODUCTIVE SERVICES FOR THE YEARS 1909-1910, 1914 AND 1916-1917 IN BILLIONS OF DOLLARS[1]

	1909-1910	*1914*	*1916-1917*
Agriculture	5.5	6.1	14.3
Manufactures	8.5	9.9	14.8
Mineral	2.0	2.1	3.5
Fishing	0.05	0.1	0.1
Transportation	2.8	3.0	3.5
Commercial and professional	9.0	10.0	13.5
Total	27.85	31.2	49.7

The figure of fifty billions for the income of the nation in 1917 refers, of course, to gross income. What proportion of these fifty billions may properly be regarded as surplus or clear income—that is to say, income over and above what the people of the country must consume in order to keep themselves in a state of health and

[1] In estimating gross values of national industry by principal branches, production figures of the Census Bureau, the Department of Agriculture, the Geological Survey and other federal agencies were used. Figures for 1916-1917 are more conjectural than those for 1909-1910 and 1914 for the reason that the value of manufactures, or the total "Value added by manufactures" had to be estimated largely from incomplete output data of certain basic industries and wholesale prices prevailing during the year. In this connection use was also made of the index number of wholesale prices published by our Bureau of Labor Statistics. Figures of income of the commerical and professional classes, including persons in the public service, are rough approximations, based, in part, upon census data of occupations.

The large increases in the 1917 values of agricultural products are due largely to the higher price level and, to a much smaller extent, to larger yields. In mining and even more so in manufactures, the higher values are due both to higher prices and to larger output, as may be seen from the following

strength and that cheer which has got to be maintained even in wartime if we are to deliver our most telling blows, and to provide for the necessary upkeep of the industrial equipment of the country—is a matter upon which opinions and estimates will differ widely. Approximations, however rough, must nevertheless be attempted.

The annual savings or investment fund of the American people at the beginning of the European war was variously estimated at from three to five billions of dollars. That meant that out of the gross income of the country at that time, three to five billion dollars' worth of goods were not consumed by the recipients or owners of the income, but were invested in extensions of industry and business, or in other words, converted into additions to the financial and industrial capital of the country.

How much this actual savings fund of from three to five billions of dollars may, as a matter of fact, have been increased during the past three years, or even how much the potential savings fund of the country may have been increased by reason mainly of the vast

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tables showing yearly crop and output figures for certain leading agricultural and mineral products:

Quantities of Principal Agricultural Products for the Years Named Below

	1909	*1914*	*1917*
Wheat, 000′ bushels	683,379	891,017	659,797
Corn, 000′ bushels	2,552,190	2,672,804	3,210,795
Oats, 000′ bushels	1,007,143	1,141,060	1,580,714
Cotton, bales	10,649,000	16,135,000	12,047,000
Tobacco, 000′ pounds	1,055,765	1,034,679	1,185,478
Hay, 000′ tons	97,454	70,071	91,715

Quantities of Principal Mineral Products for the Years Named Below

	1910	*1914*	*1916*
Coal, Bituminous, 000′ short tons	417,111	422,704	502,520
Iron, pig, 000′ long tons	26,674	22,263	39,126
Copper, 000′ pounds	1,080,160	1,150,137	1,927,851
Petroleum, 000′ bbls. of 42 gal.	209,557	265,763	300,767
Zinc, short tons	252,479	343,418	563,451
Cement, 000′ bbls. of 380 lbs.	77,785	87,258	95,394

accessions to the pecuniary prosperity of the country, which have occurred in this same period of time, offers an engaging problem both for statistical enterprise and for economic inference and conjecture. My inference is that the largest part of this increase in the money income of the country may rightly be rated as an addition to the potential savings fund. The indications above given are that the money income of the country may have grown by an amount as much as eighteen billions of dollars in the past three years, due partly to increased production, partly to intensified demands for many of our staple products, but mainly to the rapid and general advance of prices. If we allow a deduction of one-third or six billions from the estimated increase of eighteen billions in order to offset increased living, or other costs (and, also, to account for variations in values computed because of steadily changing price levels during the year), we have left the sum of twelve billions of dollars as the apparent amount by which the potential savings fund of the country has been enlarged during the past three years. These twelve billions added to the actual savings fund of the country, which was estimated at from three to five billions of dollars at the beginning of the European war, would seem to indicate that the present total savings or investment power of the country, taking the *actual* and *potential* funds together, might amount to as much as fifteen billions of dollars or more for the year 1917.

The war taxes, which were imposed by Congress at its recent session, contemplate the raising of some two and a half billions of tax revenue, though there appears to be some reason for believing that the yield of the new taxes may considerably outrun the estimates. Obviously the government cannot also borrow that which it takes by taxation. Current income is the source out of which both our tax revenue and our loan revenue will be derived. If some three billions of tax revenue are taken out of the annual surplus income of the country, which I have stated my reason for believing might amount to as much as fifteen billions of dollars, then it would appear that twelve billions of dollars represents about all that could safely be raised by loans.

The authorized expenditures and advances for the fiscal year 1918, however, run close to twenty billions of dollars and leave us, therefore, with the problem of how the additional four or five bil-

lions in excess of the estimated actual and potential savings fund of the nation are to be obtained. Looking at the problem purely as a matter of dollars and cents, it must be admitted that the financing of the war on the projected scale of expenditure is far from a simple problem, even with such reassuring indications of our possible income and savings fund as I have ventured to give for the year 1917. It raises at once two extremely important questions:

(1) Can the vast sums, which it is proposed to raise from loans, be raised without causing a serious inflation of credit and prices?

(2) Is it at all possible that the war can be carried as an "extra" —that is to say, that business and living can be as usual during the period of the war?

IV

No one who looks beneath the surface appearances to the hard and inexorable realities, can for a moment maintain the position that the war can be carried as an "extra." We cannot carry the war as an "extra" and business cannot be as usual during the period of the war, if we mean to win.

I cannot believe that those who are sponsoring the doctrine of "business as usual" can appreciate the economic significance of the doctrine. This war, as the President with rare prevision told Congress and the people, will involve the "organization and mobilization of all the material resources of the country to supply the materials of war." The man who knowingly preaches the doctrine of "business as usual" at this time is, therefore, proposing that *private advantage* should be set against or ahead of *public necessity.* At this crisis in the nation's life, every business, no matter what its nature, is affected with a public interest and the public has the right, indeed owes it to itself, to determine within what limits that business shall be circumscribed in the interest of the war, or to what extent it shall be helped and fostered in the same interest. The American business system is on trial in this war. No one doubts its technical proficiency and it should not allow anyone in its ranks to raise a doubt regarding its competency to exercise vision and imagination in seeing clearly what must be done by the nation in the way of changes in our business and economic organization during the war. If it fails to rise to the occasion through weakness or selfishness, or if selfishness is allowed to hamper and hinder the development of a

rational program of economic finance, the American business system will have gone a long way toward sounding its death-knell and surrendering to other agencies the right of leadership in the great processes of economic reconstruction which must take place at the close of the war.

The truth is that nothing can be as usual while the war is on—neither business nor living can be as usual. We are in this war to win it and our children will never forgive us if we fail to do any of the things necessary to win it. The sooner we take this truth to heart and reshape our lives accordingly, each one in accordance with his circumstances, the sooner the war will be won and over. The only powers on earth that can defeat us are weakness and selfishness—selfishness in the shape of profiteering, if business is as usual, and weakness in the shape of waste and indulgence, if living is as usual. We need not doubt our ability to overthrow the enemy without, if we can control the enemies within: that is, the temptations to make money as usual and to live and enjoy as usual. Indeed, the doctrine of "business as usual" is not only vicious in its necessary economic implications for a nation in the throes of a great crisis, but is equally mischievous in its financial implications. For the twin-sister of the doctrine that business can be as usual is that other mischievous doctrine that the war cannot be financed without inflation.

V

Inflation in connection with government war financing may arise from many different causes but there are two which are of particular interest in our present situation: (1) Inflation of prices is apt to result when the government undertakes to spend money, however obtained, faster than the goods it seeks to buy are being produced. (2) Inflation, both of banking credit and of commodity prices, results when the government undertakes to borrow faster than the people are able or willing to save. In the last named case, which is the one I mean to discuss, the loans of the government, by one device or another, will be forced upon the banks. The banks will pay for the loans by an extension of banking credit and currency. The inevitable effect on commodity prices of an expansion of banking credit and currency is to raise them. It would seem to need no extended argument in this day in America to demonstrate

that banking credit in any of its typical forms is purchasing power, exerting the same effect on prices when used in payment for goods or purchases, as any other forms of purchasing media. When purchasing media are produced faster than goods are produced—in brief, when the supply of currency and credit in its increase outruns the increase of the supply of purchasable goods—the prices of goods must rise. Whether such a condition is best described by the word "inflation," the fact remains that the rise of prices of purchasable goods in such a situation is closely connected with the increased supply of purchasing media. Moreover, when the increase of purchasing media, occasioned by the expansion of banking credit, follows upon the investment of banking credit in government loans, the conclusion is irresistible that the expansion of credit and its resulting consequences in increased commodity prices are being induced by bank lendings to the government.

The process by which government loans produce inflation is disclosed in the financial history of all the great European belligerents. All of these governments, notably Germany, have made extensive use of banking credit in the flotation of their loans. Not only the great central banks, but the banks generally in the several European countries, have been put under pressure to invest their credit extensively in the purchase or carrying of government securities. The London *Economist* has repeatedly characterized the situation thus produced as "bad finance forced on the banks by the government." An examination of the changes of condition of the banks of Great Britain, exclusive of the Bank of England, shows what the process has been. Their deposit liabilities, that is to say their checking accounts, have increased between the end of 1913 and the end of 1916 about four hundred and eight million pounds sterling, an increase of close to 40 per cent. Their bills discounted on the other side of the statement show only a negligible increase, an increase of some seven million pounds sterling. Their investments, on the other hand, show an increase from two hundred and eleven million pounds sterling to four hundred and thirty-seven million pounds sterling, an increase of over two hundred and twenty-five million pounds sterling, or 107 per cent: in view of all the circumstances and known facts, it may be said that this increase is made up chiefly, if not almost entirely, of government obligations, such as treasury bills, exchequer bonds, etc. In brief, the expansion of

banking credit in England seems clearly disclosed by these figures to have been occasioned for the most part by the expansion of bank investment, directly or indirectly, in government obligations.

A similar process has been at work in the other countries of Europe. The expansion of banking credit in France and Germany however, has been more largely in the form of bank notes than of bank deposits. The bank note circulation of France increased from twelve hundred and eighty-nine million dollars in August, 1914, to forty-one hundred and seventy millions in October, 1917, an increase for the period of over 223 per cent. The circulation of the Reichsbank of Germany has risen from six hundred ninety-three million dollars in August, 1914, to twenty-two hundred and eighty-five millions in October, 1917, an increase of 230 per cent in the course of a little more than three years. This increase in the note circulation of the great central banks of France and Germany has been occasioned largely by investments of their credit in the obligations of their respective governments, and seems definitely to indicate that government borrowing has been a leading factor in the expansion of their note circulation. Doubtless other causes have contributed to the vast expansion of banking liabilities in Europe, but no one cause has probably been a greater factor than the investment by the banks of their credit in taking or carrying government loans.

Whether a similar result is to be expected here in connection with our greater government borrowings, and if so how soon, will largely depend upon whether all the people who have income enough to save will save, or whether they can be or will be made to save, enough out of their incomes to absorb such loans of the government as may be put out in excess of the ordinary or usual savings fund of the nation—that is, absorb them as savings loans, not as credit loans.

The obligations of a government, such as the United States, when considered purely from the investment point of view, are unquestionably to be regarded as the most eligible sort of investment. Commercial banks, however, in a country like ours, which makes daily use of a large body of mobile banking credits, are not to be likened to investment institutions in the ordinary sense of the word. A bank's capital is but a small part of its investment power. A bank is a *bank* only as it invests its credit. But the safe in-

vestment of its credit, as the history of banking experience has repeatedly demonstrated, necessarily restricts a bank in its choice of securities to those which possess the necessary liquid character. The objection to considerable investment by banks of their credit in investment securities, such as government bonds, arises, not out of any question as to the solidity of such securities, when well selected, but rather because of their lack of liquidity. The history of modern banking has shown conclusively that distinction must be made between "security" and "liquidity," or "value" and "availability" in determining the kind of investments which are best fitted for banks which deal in their credit. There are many forms of investment paper which from the point of view of security leave nothing to be desired, but yet which are unsuitable as the basis for the creation of a great body of currency or of active banking credit.

The doctrine set forth in the famous English Bullion Report, which came in the midst of the controversies growing out of the management of the Bank of England's circulation during the Napoleonic Wars, whose truth has since been attested by the experience of every modern nation, is that two things are necessary to protect a system of banking currency and credit against the danger of undue expansion. One of these is the *maintenance of adequate reserves;* the other is the *maintenance of adequate liquidity of investments.* By liquid investments is meant bank paper which liquidates itself in short periods of time out of the proceeds of the transactions which have given rise to the paper. That is to say, paper which grows out of transactions in trade and industry connected with the production or distribution of goods, which—as the goods are produced and sold in the normal movements of trade and industry—will supply the funds out of which the borrowings of bank credit can and will be repaid. Self-liquidating paper being, therefore, paper which is connected with productive operations in industry, that is to say, operations which result in an increase in the supply of usable and salable goods, it follows that the same banking transaction, which gives rise to an increase in the supply of purchasing media through the expansion of banking credit, also gives rise to an increase in the supply of purchasable goods through the assistance rendered the producer.

But when a bank invests its credit in the purchase of govern-

ment bonds which are issued for the purposes of war—in brief, for operations that result, not in the production, but in the consumption and destruction of goods—we have an altogether different situation. The situation is one in which there has taken place an addition to the volume of outstanding banking credit and purchasing media with little additional in the way of goods to offset it on the shelves of the shop-keeper, or the warehouse of the manufacturer. In brief, credit transactions of this sort, so far from being immediately connected with operations resulting in the increased production of *aggregate* goods, are rather to be described as connected with operations resulting in the diminution of the community's supply of purchasable goods. In war times, governments borrow, not for the purpose of producing goods, but for the purpose of getting possession of goods already produced, or being produced, goods whose production is otherwise financed. The credit created and extended by the banks to the government in the process of taking up government bonds is to be regarded as an addition to the total volume of banking credit, not called out by the needs of productive industry, but occasioned by the necessities of the public treasury—in brief, what is being financed by such a creation of credit is not the production of goods, but the acquisition of goods by a non-productive borrower.

It may be asked, in fact has been asked, how the credit created and extended by a bank in order to enable its customers or itself to take up and pay for subscriptions to government loans, can inflate commodity prices, since, it is said, credit acts on commodity prices only when offered in exchange for, or payment of, "commodities.'

The process of price inflation in the case in question, that is where the issuance of government loans is the admitted cause of bank-credit expansion, is perhaps slightly obscured by this fact, but in its essentials does not differ from the familiar and typical case of credit expansion, if sight is not lost of the fact that the credit extended by the bank in payment for bonds is merely the beginning and not the end, or the whole, of the process. The credit received by the government in payment of its bonds is not held idle in the Treasury, but is used to pay for supplies bought or contracts in process of execution and soon filters into the stream of circulating bank credit, becoming part of the aggregate supply of purchasing media afloat in the community. For when the govern-

ment takes payment in credit, it follows that it will make payment by credit, transferring the credit that it has on the books of the banks in the same way as a merchant or manufacturer would, who had been granted a credit accommodation by his bank. Moreover the credit created in first instance by the bank's subscribing to government loans and set in motion by being used by the government in payment of purchases made, keeps on moving and changing hands, passing from the hands of the government to the munitions manufacturers, from them to the steel manufacturers, and so on—in other words, lives on as a part of the general body of mobile and active banking credit until it is extinguished by some one, who, having payment to make to a bank, uses it for that purpose or until some one who wishes to buy a bond from a bank, makes payment therefor in banking credit. When that time is reached, there will be a simultaneous reduction on both the *liabilities*' and the *resources*' sides of the bank's statement. Till that time is reached, both the liabilities' and the resources' sides of the accounts will be swollen by reason of the initial transaction in government finance, which occasioned the extension of bank credit for the purpose of making the investment in government bonds.

There is much misconception with regard to the meaning of "bank resources" and the significance of increases of banking resources. From the point of view of the lending bank, the obligation of a solvent debtor is a "resource"; from the economic point of view, however, only that is a resource which in its existing state, either is or is in process of becoming a usable good. When, therefore, banks are investing their credit extensively in government securities, there may be a very great increase in the banking resources of the country, without any increase in the country's actual economic resources. But since prices—that is to say commodity prices—depend upon the ratio existing between the supply of purchasing power in terms of money, and the supply of purchasable resources in the shape of consumable goods, it follows that an increase of bank resources not offset somewhere in the economic process by an increase of economic resources in the shape of consumable goods, must and will lead to a rise of prices.

It can hardly be doubted in view of the known facts of the case that the great increase of prices which has been experienced throughout the belligerent countries of Europe is, in large measure, due to

the multiplication of the means of purchase and payment by their banking systems, more rapidly than the multiplication of the goods available for purchase by their industrial systems. Nor can it be doubted that a considerable part of the rise of prices, which we have experienced in our own country since the beginning of the European war in 1914, has been induced by the great body of new banking credit created, which has outrun in its expansion the growth in the productive output of the country. The rise, moreover, has continued since our entry into the war. The index figures compiled by the Bureau of Labor Statistics show that while wholesale prices in April 1917 were 74 per cent higher than in July 1914, they were 89 per cent higher in July 1917. It seems likely that if later figures were available, they would show the forward march of prices to be continuous. The rise of prices experienced in this country, though much less than that which has taken place in the leading countries of Europe (the price index compiled by the London *Economist* showing an increase between July 1914 and September 1917 of 120 per cent) is yet sufficient to awaken serious concern, for causes not dissimilar in their general character and incidence have been operating to produce the rise of prices in both England and the United States, most notable among them, as already indicated, being the expansion of banking credit.

How rapid the expansion of banking operations in the United States has been during the past three years is definitely indicated in the striking figures for the items "total deposits" and "loans and investments" which have been assembled in the sub-joined tables, based upon the data compiled in the office of the Comptroller of the Currency.

TOTAL DEPOSITS OF ALL BANKS IN THE UNITED STATES EXCLUDING SAVINGS BANKS AND PRIVATE BANKS
(Bank, individual and government)
(In millions of dollars)

	June 30, 1914	*June 23, 1915*	*June 30, 1916*	*June 30,[1] 1917*
National banks	8,543	8,819	10,856	12,767
State banks	3,407	3,460	4,518	5,672
Trust companies	4,283	4,603	5,728	6,413
Total	16,233	16,882	21,102	24,852

[1] Report of national banks as of June 20, 1917.

LOANS AND INVESTMENTS OF ALL BANKS IN THE UNITED STATES EXCLUDING SAVINGS BANKS AND PRIVATE BANKS
(In millions of dollars)

	June 30, 1914	*June 23, 1915*	*June 30, 1916*	*June 30*[a] *1917*
National banks	8,345	8,728	10,127	11,936
State banks	3,268	3,304	4,073	5,003
Trust companies	4,163	4,395	5,307	6,102
Total	15,776	16,427	19,507	23,041

It appears from these figures that both deposits and loans and investments have grown in the United States at a very rapid rate since the beginning of the European War in 1914. The growth of bank deposits between the end of June, 1914 and the end of June, 1917 was eight billions six hundred millions of dollars, a gain of 53.1 per cent. The increase of loans and investments between the same dates was seven billions two hundred sixty-five millions of dollars, a gain of 46.1 per cent. Adequate data are not available for estimating with accuracy the trend of development since the end of June last. The abstract of the Comptroller of the Currency for September 11, 1917, however, shows a gain of four hundred sixty-one millions of dollars in deposits of the national banks between the dates of June 20 and September 11, and of three hundred forty-five millions of dollars in the loan and investment account for the same period. Much more striking is the trend latterly disclosed by the reports of the clearing house banks of New York City, covering the period which has elapsed since the date of the last call of the Comptroller: between the dates of September 8 and November 3, 1917, the loans, discounts and investments of the clearing house banks increased from $3,850,652,000 to $4,510,385,000, a gain for a period of eight weeks of $659,733,000 or 17.1 per cent. Demand deposits for the same period increased from $3,675,490,000 to $4,136,335,000, a gain of $460,865,000 or 12.5 per cent. The trend of development in such a highly sensitive center as New York—the most important banking center of the country—is not of itself, of course, to be taken as measuring the banking trend in the country at large but it may be taken as indicating the general direction in which banking operations are moving. Taken with other—minor

[a] Report of national banks as of June 20, 1917.

and less significant—indications which need not here be detailed, it seems not improbable that, if adequate data were available, they would show an increase of some 10 per cent, or from two to three billions of dollars, in both the deposit account and the loan and investment account of the banks of the country since our entry into the war.

It can hardly be doubted, I think, in view of the facts and probabilities thus outlined that the expansion of banking credit, which has been in progress in the United States since shortly after the opening of the year 1915, has already produced a condition of serious price inflation. The evidence seems unmistakable that inflation of credit and prices is already at work and that, in the matter of inflation, we are confronted, not by a theory, but by a condition—a condition which there is reason for believing will be aggravated if undue reliance is put by the country on banking credit as a competent economic method for financing the loan requirements of the government.

If we examine the movements of the federal reserve banks in recent months, we get some light upon one of the factors which have helped to sustain the most recent phase of the expansion of banking credit which is under review. Between the dates of April 6 and November 2, federal reserve banks increased their holdings of bills discounted and purchased from $100,663,000 to $689,977,000, an increase of $589,314,000 or 585.4 per cent. Federal reserve notes in circulation increased for the same dates from $376,510,000 to $881,001,000, an increase of $504,491,000 or 133.9 per cent.

When it is recalled that the reserve banks are bankers' banks and that investments made by reserve banks of their credit in discounted or purchased bills, appear on the books of the borrowing or selling banks either as cash balances or as additions to (or replenishments of) their cash holdings,[4] it is evident that an increase of five hundred eighty-nine millions of dollars in reserve bank investments was quite sufficient, so far at least as amount is concerned, to sustain an increase of from two to three billions of dollars in the operations (loans and deposits) of the banks of the country. Whether any such direct and definite connection between the operations of the banks of the country and the operations of the federal

[4] In other words, as the customary and necessary provision of cash or cash credit, which, in the accepted nomenclature of banking science, is called "reserve."

reserve banks can, as a matter of fact, as yet be said to exist, is of course very doubtful. But the connection between the operations of the federal reserve banks and the growth of their member banks' operations will probably have to be regarded as close enough to justify the view that the recent rise in the volume of reserve bank operations has been a factor of consequence in sustaining the most recent phase of the expansion of banking credit which has been noted.

If this rise continues, it is not unreasonable to expect that in time such use of the rediscount facilities of the reserve system might convert it into a great engine of banking inflation. The situation is therefore one which suggests the advisability of careful attention being given to the character and growth of the operations of the federal reserve banks in these critical times, lest they be made to bear an undue share of the burden incident to the borrowing operations of the government.

The credit potentialities of the federal reserve system are vast. The twelve banks composing the federal reserve system have an aggregate capacity of credit expansion of about two billions of dollars. If we assume that one dollar of reserve bank credit increases by not more than sevenfold when transmuted into the credit extended by a member bank to its customers, it is clear as a proposition of banking arithmetic that the federal reserve banks and member banks of the federal reserve system, taken together, have an additional credit capacity of some fourteen billions of dollars.

The question which I believe, in view of this situation, the country must soon face, is whether it will be the part of financial prudence for us to attempt to finance our government loans by an expansion of banking credit with accompanying inflation of prices, or whether it will be better, however drastic the steps necessary to accomplish this result may be, to pursue the course of converting the potential savings fund of the nation into an actual savings fund of sufficient magnitude to absorb the loans of the government as *savings loans.*

VI

It does not fall within my province in this article to discuss the different steps which are likely in the end to recommend themselves to the mature judgment of the nation, if the people are to be pro-

tected, again to quote the President's language, "against the very serious hardships and evils which would be likely to arise out of the inflation which would be produced by vast loans."

One or two general observations may, however, not be out of order. It will be the part of prudence for us, I believe, to look into the future as clearly as we can and try to estimate how far we shall have to reshape or supplement our traditional financial and economic methods in order to adapt them to the unusual character and unprecedented dimensions of the financial and economic situation, which the war is presenting: *Whatever will have to be done in the end would better be done as soon as public opinion can be brought to accept it.*

The traditional methods of finance are everywhere showing themselves inadequate, unless accompanied and reinforced by thorough-going changes in the general organization of industry from a peace basis to a war basis. The weakness and defect of much of the current discussion of war finance is, as I view it, that it does not seem to comprehend the way in which the whole problem of financing the present war has been utterly transformed by the stupendous magnitude of its financial requirements. Current discussions run too frequently in terms of the traditional finance. There is too much discussion as to whether loans or taxation should be our main reliance in financing the war, and too little discussion of the changes which have got to be made in our whole economic organization in order that any financial system we may devise will prove effective in putting the government quickly and continuously in possession of the vast streams of supplies of all sorts required for the war. The financial problem, at best, is only partly a *financial* or money problem—a problem of getting the wherewithal to buy and pay. Chiefly it is a problem of getting the goods and services to buy.

Obvious and important, therefore, as a system of well-distributed taxation is, as an alternative to inflation as an expedient of war finance, it can never be more than a partial solution of our difficult financial problem. When the system of war taxation, the foundations of which were laid by Congress at its last session, is carried to its furthest practicable limits, there will still remain a very, very wide margin of war expenditure—perhaps the largest part—which will have to be taken care of out of the proceeds of loans. Our major financial resource is bound to be the loan and one of our

major financial problems, therefore, to prevent the loan from deteriorating into an inflation. Specifically and positively the problem is as to how we may best proceed in putting and keeping the loan on a basis of financial safety—that is on a solid foundation of industry and thrift. The way to this result was pointed out by the President in words which have already been quoted and which can not too often be repeated:

(1) by "every man and every woman" assuming "the duty of careful, provident use and expenditure as a public duty" and;

(2) by "the organization and mobilization of all the material resources of the country"—

the organization, be it observed, not of a part, not of so much as can be conveniently spared, but the organization of *all* the material resources of the country "to supply the materials of war and serve the incidental needs of the nation in the most abundant and yet the most economical and efficient way possible." And all that this or any financial conference can do; all that any executive department of the government can do; all that Congress can do is to work out in suitable legislative and administrative detail the terms of the President's equations.

In sum, we must, as a nation, produce more and consume less. This, in its simplest terms, must be our national formula of finance. We must produce more of the things which the nation at war requires and, in order to set free the nation's productive forces to accomplish this result, we must consume less of the things which the nation in war-time does not require, even though it has been our national habit in peace-time to consume such things in unstinted measure.

Whether the various agencies of governmental administration which have thus far been set up for adjusting the economic life and activities of the nation to a war basis, will prove adequate to accomplish the result, may be doubted. Much has already been accomplished, but much remains to be accomplished and time is of the essence of success. It may well be expected, should the war run on into a second year, that a more authoritative status will have to be given to these special agencies if they are to be made fully competent to give effect to the war-will of our people on its economic side, and that they will not be able to achieve the necessary results

until they are clothed with the power to say what shall, and what may not, be done in the field of industry, or to define the limits within which this thing or that thing will be permitted.

I believe that the people of the country, when the issue is put before them intelligently and squarely, will not hesitate to accept whatever may be involved in a sound financial program with the same conviction and courage as they accepted the war. No nation ever went into a righteous war more deliberately than did the United States. The people, in assuming the obligation of war, I believe, also understood that they were assuming the responsibility of properly providing for its conduct and I am inclined to think that the great body of plain living and plain thinking people in this country are capable of comprehending what this means in the way of a sound financial program. Whether it may mean taxation carried to the farthest limits, compulsory saving, industrial conscription, priority of industry or priority of credits, the response will be made by the people if the call is authoritatively made upon them. It is my belief that beyond what is ordinarily appreciated, the country is ready for whatever may be involved in the thoroughgoing and effective prosecution of the war, for the country is realizing that this is a war of blood *and* iron, and that until we have effectively mobilized our iron, we shall not be in a position to bring the war to a conclusion which will "make the world safe for democracy."

THE ARGUMENT AGAINST INFLATION FROM GOVERNMENT LOANS

By Alexander D. Noyes,
Financial Editor, New York Evening Post.

After Professor Hollander's comprehensive statement of the economic theory bearing on this question, and Mr. Miller's thorough review of the general principles involved, I feel as if further comment would be superfluous. What I shall endeavor to do, however, in this article, is to direct attention particularly to the plain and practical aspects of the question in the light of experience.

The broad field over which Mr. Miller's article carries us diverts attention from the actual subject—which is not, Are we in danger of inflation? but, Do government loans cause inflation? It is not enough to say that there is inflation and that there are government loans, and that therefore the loans may have caused the inflation. Even accepting Mr. Miller's facts and figures regarding inflation of bank credit, we must still inquire where and how that inflation occurred, and what its precise relation is both to the government loans and to what we ordinarily accept as the economic consequences of what we call inflation.

But the question, Do government loans cause inflation? is one of those questions in which the dispute is apt to hang upon definitions. What do we mean by inflation? If we mean inflation of the currency, then the answer is that government loans may cause inflation, but that it can happen only through the use of special machinery whereby paper currency is deliberately put out on the security of the government bonds. This has occurred during the present war in the case of Russia, whose state bank, which issues the paper currency of the nation, has increased its note circulation $7,500,000,000 since the war began, while increasing its holdings of Russian government bonds by $5,600,000,000 and not increasing its gold reserve at all. It is so in a less degree in the case of France, where the Bank of France reports $2,400,000,000 advances to the government for war purposes and $600,000,000 for loans to the allies of France; against which obligations there has been an in-

crease of $3,000,000,000 in the note circulation of the bank with no proportionate increase in its gold reserve.

It is difficult to say how far the increase of two thousand million dollars or so in note issues of the German State Bank is connected with loans on government bonds; but there is no doubt of that connection in the case of the German loan bureaus, which have issued $1,500,000,000 currency, unsecured by a gold reserve, on all sorts of collateral. The process was at work in a degree during our Civil War, when note issues of the national banks were permitted only on the security of United States government bonds, and when $236,000,000 of such newly issued bonds were acquired in war time for that purpose. But it will be observed that this is only a possible result of the policy of government loans, not a necessary one. It cannot be said that it is an inherent effect of such loans. It is not in any respect a probable direct result of our own war loans.

If by "inflation" we mean expansion of credit, then again the issue of government loans might have that effect, or it might not. Very large issues of new securities, whether by governments or corporations, will usually cause a large increase in the loan account of banks. Individual subscribers, when the loan is especially attractive or when (as nowadays) the motive of patriotism is invoked to increase the subscriptions, are apt to borrow from their banks money to pay their subscriptions. Most of them will expect to pay back such loans from their future accruing income. But the bank loans may be made permanent for the period of war or longer. In Germany they are explicitly made so.

But what most people mean when they talk of "inflation" is a third possible result—the abnormal raising of prices for commodities. It was undoubtedly this kind of inflation, as a consequence of large war loan issues, which President Wilson had in mind in his remarks on the subject in his war speech to Congress on April 2. He then said, regarding the financing of the war:

> It will involve of course the granting of adequate credits to the government—sustained, I hope, so far as they can equitably be sustained by the present generation, by well conceived taxation.
>
> I say sustained so far as may be equitable by taxation, because it seems to me that it would be most unwise to base the credits, which will now be necessary, entirely on money borrowed. It is our duty, I most respectfully urge, to protect our people, so far as we may, against the very serious hardships and evils which would be likely to arise out of the inflation which would be produced by vast loans.

This clearly has reference to inflation of prices. Let us see how the issue of war loans, taken by itself, would have that effect. We know from all economic experience that sudden and large increase of a paper currency irredeemable in gold will drive up prices. It will do so because prices will be quoted in that currency, and, since in due course the paper currency itself will be worth less than its face value in gold, "paper prices" will necessarily be higher than the previous "gold prices." In so far, therefore, as new government loans are made the basis for paper currency issues and that currency is not redeemed on demand in gold, the government loan policy will undoubtedly inflate prices.

But prices are sometimes driven up also through the mere fact of expanded bank credits. When every producer, middleman, or retailer, can get and does get on easy terms abundant credit at his bank, he will be in no hurry to sell. If he chooses, he may hold for higher prices, and the fact that demand is apt to be increased all along the line because easy access to bank credit will facilitate the paying of such prices by middleman, retailer and consumer. This explains the well known fact that rising bank reserves, easy money and constantly expanding bank loans, are an invariable accompaniment of what we call "good times," and that they figure both as cause and consequence of the rising prices which then prevail.

But is this the case with a bank loan expansion caused, directly or indirectly, by subscriptions to large government loans? That is the real question, and I cannot agree with what I understand to be Mr. Miller's position regarding it. Inflation of bank loans there may be, and inflation of prices there may be; but what we have to determine is, whether the government's bond issues caused both. I think the answer must be in the negative. When banks are compelled to expand their loans very heavily in order to facilitate subscription to the government bonds, there will be less, not more, left in their legitimate credit fund to apply to ordinary commercial loans.

It is perfectly true that such a situation may be modified, through deliberate action of the banks, through special facilities offered by the reserve banks in rediscounting loans secured by the new war bonds or through other causes. But we are talking now of the actual effect of the war loan issue itself. In that regard it ap-

pears to me that the ordinary credit facilities of the banks, which might be utilized to hold up prices in the commercial markets, will not be increased by the government bond issue, and that they may be very considerably decreased.

Such new credits as are obtained by subscribers to a war loan are spent in the subscription, and they are therefore evidently not available for any commercial purposes. No doubt the war bonds may themselves be used under the law to create new bank reserves through rediscount of loans secured by such bonds. But exactly the same thing may be accomplished through rediscounting of loans secured by commercial paper; and since the requirement of cash reserves in the federal banks fixes a limit to the aggregate rediscounts, it follows that the more of them a bank makes on the basis of loans secured by war bonds, the less it can make on the basis of loans secured by merchants' notes.

As to whether the rise of prices incident to any prolonged war would not be greater if the war is financed by government loans than if the war is financed by taxes, that is another question. Imagining that the present war, for instance, were financed solely by taxes, bearing heavily on every individual, the rise in prices would unquestionably be less than it has been. But that would be so, chiefly if not wholly because the weight of taxation would have made the average citizen able to buy very much less of the ordinary necessities than he had bought before. This, however, is something like begging the question, for the man whose means of buying necessities is cut off will scarcely be in a better position than the man who, with an unchanged income, has to pay more for them. If, as is the case in our present scheme of war taxation, most of it is raised by heavy exactions from very rich individuals, reduced personal expenditure may not result at all. A 60 per cent tax on a million dollar income will not compel that taxpayer to curtail his purchases of necessities. The public mind is sometimes apt to lay stress on the fact that proceeds of these huge loans are used in buying food and material on an unprecedented scale, and that therefore the loans cause the resultant high prices. But it is the government's purchases, not its borrowings, which act directly on prices of commodities, and since the war material must be had, in one way if not in another, the government demands would equally affect supplies and prices if the material were purchased wholly out of the proceeds of taxation.

The sum of the matter is then, that government loans, especially when issued in the present prodigious amounts, may cause inflation of the currency, but will not do so unless both the machinery to facilitate it and the disposition to undertake it are in evidence; that government loans will probably result in increase of bank loans to subscribers; but that the increase in bank loans for that purpose will of itself have no effect in the way of inflating prices, and might, through absorbing part of the credit fund usually reserved for commercial borrowers, act indirectly as a check to rising prices. The primary cause of the present high war-time prices is the enormous demands of governments in connection with the war, along with the impairment or blockade of many ordinary sources of supply. The secondary cause is the currency inflation and currency depreciation in Europe, which have indirectly affected prices (partly through shipment of gold from the depreciated currency markets) even in countries whose currency is not depreciated. That the government loans, except as they have been deliberately used as a basis for currency inflation, have in themselves been a cause for the rise in prices, I believe cannot be proved.

WAR LOANS, INFLATION AND THE HIGH COST OF LIVING

By Carl Snyder,
Author of *American Railways As Investments*, New York City.

The relation of government loans to inflation seems more a question of fact than of theory. At least in a broad way there seems no inherent reason why such loans should cause inflation, or even expansion. A very large part of the loans is paid for by check—probably 75 per cent or more, so that the actual flotation means little more than a transfer of bank credits. There is no withdrawal from or addition to the currency of the country; therefore on the modern theory, no effect upon prices. And I am taking it that the question of inflation is purely a question of prices—that if there has been no rise in prices there has been no inflation.

Ways in which Loans Cause Inflation

But as a matter of fact such loans do cause credit expansion; and therefore the question is, how? Certain ways are obvious.

First. There is always a great deal of hoarded gold, in small sums and large. And there is nothing like a great national crisis and an offer of government bonds to attract this gold from its hiding places in safety deposit vaults and old stockings and the like. So, for example, Germany without importations from abroad, has since the war began nearly doubled its visible gold holdings. As you know it has even encouraged the melting of plate and jewelry of all sorts. This gold has been exchanged for bank notes, but the effect would not have been very different if the gold had been exchanged for government bonds and then been placed where it was most needed—in the banks—to build up credits.

Second. A government loan, unless the proceeds are sent abroad, means government spending on a huge scale; and there is nothing like this spending to speed up business and therefore prices. If it now happens that this falls at a time when the banks are not loaned up to the limit and have room for credit expansion, this expansion is pretty sure to take place. That was actually the case

last April when we entered the war. The banks were up to less than 90 per cent of what might be regarded as a normal safe maximum of loans; and they could therefore expand credits by at least a billion and a half, and conceivably a great deal more. If they could exchange for gold the billion or more of governmental securities which our banks have loaded up with since the war began, then even the normal expansion might readily be five or six billions; and as we shall see in a moment it could now be vastly more.

Third. Credit expansion naturally follows from the creation of a huge amount of good new bank collateral. Thousands of people will, in war time, buy bonds with the feeling that they can be realized on at any moment; and that moment usually comes for such people rather soon.

Fourth. A way has been, as it were, created by the new income tax law, assessing the unused surpluses of corporations at 10 per cent per annum. If these surpluses are converted into government bonds this tax can be avoided; and the bonds can then be used as collateral to 80 or 90 per cent of their face value and, under pledge of the banks, at the same rate of interest the bonds themselves bring. These loans reappearing as deposits, we should have then two deposits where there was only one before, and the credit currency has been expanded by a corresponding amount.

Fifth. In England and Germany, and probably more or less in all countries, the war has occasioned heavy government borrowings from the banks, these borrowings being repaid from time to time by the flotation of enormous loans. This borrowing, of course, being paid out to contractors and others, promptly appears as deposits and the volume of credit has therefore been expanded by about the amount so borrowed. This, in the judgment of *The Economist* of London, has been the principal form of credit expansion in England and chiefly responsible for a rise in prices of 135 per cent to date. So far this method has not been resorted to in the United States.

Sixth. There still remains the highly important matter of financing the loans themselves directly by means of bank credits to the buyers. This has been the chief means of flotation of the two loans so far put out in this country. I have asked several banking officials to estimate the extent to which it has been employed and they seem roughly to agree that on the first liberty loan for two

billions, the banks may have loaned somewhere near half the total, and on the second loan even more. No such expansion was evident in the national bank statements between June and September; but the answer of the bankers is that first, a large part of these loans was repaid with surprising rapidity, and second, that in this period there was a considerable curtailment of general business credits. The next bank statement will give us a better idea of the facts; for it is probable that the advances on the second loan would not be repaid so quickly, if for no other reason than that they may have been two or three times as large as on the first.

We see, then, that as a practical matter government loans may cause a heavy expansion of bank credits, and even, as in the case of Germany, a very considerable addition to the metallic basis of these credits. The question remains: When and how does such an expansion become inflation?

Money and Prices

Here is the old, old problem of the relation between money and prices. There may be modes of inflation which do not spell high or rising prices; but they are of academic interest only. In the same way there may be other ways in which prices may be inflated than by the simple one of currency inflation, but I do not think I shall go beyond the bounds to say that these have no practical interest. As to the main issue, we are coming finally to a general agreement.

For example, our general stock of money now is between four and five billions. I do not suppose there is an economist living who would suggest that the government could flood the country with an issue of say ten billions of paper money without an enormous rise in prices. This is what Russia has done and the general increase in prices there, a reliable index being lacking, has been estimated at from 250 to 400 per cent. The whole controversy has always been rather a question of degree. I am of those who believe that the whole problem was cleared up and put upon an inexpugnable basis more than thirty years ago by our own Simon Newcomb and Professor Shield Nicholson in Britain, and later by the statistical investigations of Professor Kemmerer and the splendid work of Professor Irving Fisher. The whole theory, as you know, is expressed with the simple formula that prices vary directly as the volume of the actual currency employed, and its rate of turnover or velocity, and inversely with the volume of trade.

Now as everyone knows, our main currency is in checks drawn against bank deposits. More than 90 per cent of the colossal exchanges of the nation, soaring now toward perhaps a thousand billions a year, are effected by means of checks. The volume of actual money in circulation is of slight consequence. Bank deposits in their turn are largely created by bank loans—80 per cent and more. The total of these loans is always many times the total stock of actual money. So, on the present-day theory, *the level of prices* represents a ratio between *bank credits* and *the current volume of business.*

I have found this simple fact very puzzling to many people. But it becomes very clear when we imagine the banks restored to their old note-issuing power and giving out newly printed bank notes when they make a loan instead of merely entering a credit in their books. Anyone can see that an excessive issue of such notes would mean currency inflation; and an excessive expansion of deposits has the same effect. It follows, therefore, that if bank credits are expanded more rapidly than the actual volume of business we have a rise in prices, that is to say, inflation. This is the whole matter in a nutshell.

Now what is the actual situation in regard to business in this country? The railroads cannot haul any more goods. The government is already stepping in to shut down on shipments on certain lines of industry. We cannot get any more coal unless labor is drafted from other industries. And as a whole we cannot get any more labor, as is evident from the fantastic wages that are now being paid. In a word, production, and therefore the actual volume of exchanges is practically at the limit and has been for a year or more. No expansion of bank credits can put this production any higher. It follows, therefore, as a practical fact that *any expansion of bank loans now means inflation*—to all practical intents, dollar for dollar.

Effects of Credit Expansion

Every scheme which increases bank credits spells increased cost of living and the discontent and social unrest that go with it, to say nothing of the genuine distress of millions of people whose incomes and salaries are more or less fixed and incapable of quick adjustment. With expanding credits, all the executive edicts and price fixings and food administrations in the world cannot keep prices down.

You might just as well think to restrain them with a bunch of feathers after you have put under them a 30,000-ton hydraulic jack.

Now if all this be true, in encouraging tremendous credits on the purchase of government bonds, the administration and our bankers have to that extent deliberately set out on a policy of higher and higher prices. The slogan "Borrow and Buy" means in its effect exactly the same as if the government had printed a corresponding amount of fiat money and turned it loose, as in the days of our Civil War.

The war has already added to the stock of this country a billion of new gold, which has resulted in a credit expansion of nearly 50 per cent and a rise in general prices of nearly 100 per cent. This means that the war will cost us, as it is costing England and other nations, roughly twice what it would have cost if there had been no such inflation. If we go on expanding banking credits at the same rapid rate, the cost of living and of the war will be doubled again.

And after all this inflation comes the inevitable *de*flation which always follows wildcat finance, just as it did in the years following the Civil War, with the result of making the burden of debt at least twice as great as it otherwise would have been if inflation had not been resorted to. One-half of the cost of the war in Europe has come within the last year and in turn the second year's cost was almost double that of the first. If we spend fifteen or twenty billions this year, it may readily mean thirty or forty billions next year, and if the war lasts three years more, as many believe it will, our burden of debt may readily reach a total of fifty or sixty billions, or more. The practical question then is whether this shall be met by "genuine saving," as the editor of *The Economist* terms it, or by some form of inflation, as has been true of all the nations of Europe?

Possible Inflation under the Reserve System

I do not know how many among you have considered how far the inflation of our actual currency may go. The volume of checkable deposits is now around fourteen billions. Will it stagger you to know that a prominent New York banker estimated that bank loan expansion, if the war lasts, might readily reach *fifty billions?* And all of this is provided for under our new Federal Reserve System. It is strange how few people realize the perfectly fantastic possibilities of credit expansion which were created by the new

amendments to the Federal Reserve Act passed last June. Under these amendments the required reserves were cut more than half over those formerly enforced under the national banking system and instead of these reserves being in gold or lawful money, they are now to be nothing more than book credits with the Federal Reserve Banks. And in turn these banks have only to hold a 35 per cent gold reserve against these credits.

It follows, therefore, that every dollar of gold may become $3 of federal bank credits, and each dollar of this may in turn become the basis of $8 of credits for the central reserve cities, $10 for the smaller cities and $15 for the country banks, which works out to a practical average of $10 for all the banks of the Federal Reserve System.

The Federal Reserve Banks have now on hand a billion and a half of gold. If the present movement to bring in all the eligible state banks, trust companies and the like is successful, this gold reserve may readily reach between two and three billions, and therefore serve as a basis for fifty or sixty billions, or more, of bank credits.

You will see, therefore, that the new reserve system has created possibilities of inflation never dreamt of since the Civil War. And all that stands between the general public and this inflation and the dizzy level of prices which it would bring in its train is the good sense and conservatism of our bankers, with such encouragement as they may receive from a political board at Washington and their political appointees, the governors of the Federal Reserve Banks.

So far this source of inflation has remained practically untouched.[1] Would it be possible to leave it untouched, no matter what the exigencies of the war? Is it the counsel of perfection to suggest that any great war can be fought without inflation? I know there are many able and conservative economists, as for example, Mr. George E. Roberts, who are inclined to doubt if it could. On the other hand, Mr. Hartley Withers, the editor of *The Economist* of London, has preached this very counsel from the

[1] *Note of December 5.* Since this article was written, this bank credit inflation seems under way on a gigantic scale.. In a few weeks the loans of the New York banks alone have increased more than half a billion, an expansion without parallel in the history of the Clearing House. Coincidently Dun's *Index of Commodity Prices* reaches the highest point in its history. Yet there seems not a single journal of influence in America, not a member of Congress, or senator who understands the problem or offers a word of protest or warning.

beginning of the war; and has unweariedly attacked the ineptitude of the British government and its makeshift finance. If such a policy would be possible to England with an ante-war income of not much over ten billions of our money, assuredly it would be possible for the United States with an ante-war income of at least three or four times this.

A Problem of Expediency

The problem as I see it is the everlasting one of expediency. Obviously inflation is "the easiest way." As the slang phrase goes, it is "easy money." Our bankers feel highly patriotic when they turn in for a tremendous campaign for bond subscriptions; and Mr. McAdoo and the administration at Washington feel highly elated when they roll up five billions of subscriptions, half of which are merely bank loans. It seems to matter little that all this may add two or three billions to the already swollen credit currency, and that the millions of poor people, small investors and life insurance holders who cannot expand their incomes in any adequate way must pay the piper. These are the millions who rarely have any voice in national affairs, and all the more so because they are for the most part un-understanding and dumb. To them matters of finance and economics are a seven-sealed book, and there seems to be no one save the most ignorant and demagogic of politicians to give heed to their wrongs.

But the alternative to inflation would be a sharp curtailment of our reckless national extravagance; it would mean drastic saving and the almost total discontinuance, for example, of the manufacture of a million five hundred thousand new automobiles a year. It would mean a contraction rather than an expansion of credits. It would mean tight money and high interest rates. And all this is practically what no business man or borrower or any political administration ever wants. Everybody wants easy money, flush times and three rousing cheers for the success of a loan campaign, no matter how it is achieved.

It seems an idle consequence that we may spend perhaps ten long weary years of "hard times," of falling prices, declining business and sharp distress, paying for the orgy of inflated prices, waste and extravagance in which we are now indulging.

PRINCIPLES OF EXCESS PROFITS TAXATION

By T. S. Adams, Ph.D.,
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The following paper deals with a few of the larger problems of the excess profits tax; its scope and character, the general principles upon which it rests and with whose validity it must eventually stand or fall. In discussing these topics I speak not only unofficially, but tentatively; I express only my personal opinions, and those opinions are subject to later revision.

I

The excess profits tax law itself fairly bristles with legal and administrative difficulties. Section 210, for instance, considering cases in which the administrative authorities are unable satisfactorily to determine the invested capital, provides another and a satisfactory method of determining the deduction, but says nothing about the rates of taxation which depend, in a very important way, upon the amount of invested capital itself—which amount, this very section assumes it is impossible satisfactorily to compute. In other words, at this part of the law there is an open chasm. The law, as it were, starts to bridge a gulf but terminates abruptly when we are half way across.

This is but one of the scores of problems raised by the excess profits tax law. It would be useless to attempt to settle them here. I mention them merely to suggest that any judgment of the fundamental character of such a law must be a charitable judgment. We must expect some inconsistencies. Any interpretation of the fundamental purpose and intent of the law will be sufficient if it harmonizes and synthesizes its main provisions.

The unusual technical difficulties of the excess profits tax have brought about a significant change in the administrative procedure of the Treasury Department. Breaking boldly with past departmental practice, the Secretary of the Treasury has sought to enlist the coöperation of the taxpayers themselves and has appointed a group of Excess Profits Advisors to assist the Commissioner of In-

ternal Revenue in construing and applying the law. This is an administrative departure so striking as to be almost revolutionary. Hitherto the taxpayer and the tax gatherer have held each other at arm's length. We have, as a people, come to look upon the taxpayer with suspicion, and the belief has grown up that the word of the taxpayer, or even his oath on a tax return, is likely to be untrustworthy and misleading. The great war in which we are now engaged, along with indescribable evils, has brought some priceless boons, chief of which is a deeper recognition of the necessity of coöperation. We must work together lest we all go down in the general collapse of democratic government. And among the forms and varieties of coöperation, the strangest perhaps, and not the least attractive, is the proposed coöperation between those who pay and those who collect taxes. Tax paying and tax gathering may be made different and far more wholesome things if this experiment with the Excess Profits Advisors be successfully carried out.

II

"This title," the excess profits tax law reads, "shall apply to all the trades or businesses of whatever description, whether continuously carried on or not. . . ." The tax, therefore, is laid upon trade or business. But a preceding paragraph provides that every corporation or partnership not specifically exempt shall be deemed to be engaged in business, and that all its income, from whatever source derived, shall be deemed to be received from such trade or business. In the case of partnerships and corporations, there is but one business, one income; and the latter, with some specific exceptions, is the income returned for purposes of income tax.

In the case of the individual, however, the situation is probably different. True, professions and occupations are specifically included in the general category of trade or business, and we all know by this time that the excess profits tax applies to salaries. But in all probability, the tax does not cover, in the case of the individual, income derived from mere ownership, in which the element of active business management or personal exertion is substantially absent. In the debate upon the excess profits tax in the House of Representatives, Mr. Cannon pointedly asked whether income derived by "a

gentleman of leisure," as such would be subject to the excess profits tax. Mr. Kitchin replied with an emphatic negative:

I do not think in the case the gentleman cites that the individual would pay any excess profits tax, as he is not engaged in trade or business and has no profession or occupation. He, of course, would pay an income tax. The difference between the excess profits tax and the income tax is this: The income tax is upon the total net income received from all sources, with a few certain exceptions. The excess profits tax as now written in the bill is a tax on trade or business, including professions and occupations; that is, on the income or profits of trade or business, including professions and occupations.

But if an individual is in business—say in the mercantile business—and has investments in railroad stocks and bonds and receives $10,000 from them, disconnected altogether from his business, that would not be included in determining the income subject to excess profits tax.

The fortunate individual, therefore, who "lives upon the income from his capital," will not be subject to excess profits tax, if Mr. Kitchin's interpretation of the law be correct. The salaries or fees of the typical professional man, the brain worker, are taxed. The man who risks his capital and puts his energy into a competitive business of the ordinary kind is taxed. But he who lives quietly on his rents, his dividends and his interest receipts, is not taxed.

Indeed, the whole status of the investor under the war revenue bill is a significant one. The income which he derives from securities may be subjected to very heavy income tax. But the new income tax law, in a section which I shall not quote in detail though it deserves careful exegesis, provides with significant exceptions that dividends shall be taxed to distributees at the rates prescribed by law for the years in which the profits or surplus (from which they are paid) were accumulated by the corporation. As a result of this provision, millions of dividends distributed this year will not be subject to the heavy war income taxes but will pay at the lower rates applicable in the past. Moreover, in its final formulation, the war revenue bill omitted a clause previously adopted by the Senate which prohibited those contracts by which the borrower or debtor undertakes to pay any tax imposed upon the interest or income going to the lender or creditor This, I say, was stricken out. The result is congressional endorsement of a practice which, in most foreign countries, is regarded as contrary to sound public policy. We encourage, in short, the multiplication of those covenants by which debtors undertake to pay taxes levied in the first instance upon creditors.

I raise these questions concerning the status of the investor in the scheme of war taxes, not for the purpose of criticism, but to bring into clear relief some of the larger aspects of our general tax policy. So far as dividends and the excess profits tax are concerned, the case is clear. The corporation from whose earnings dividends are paid, being duly subject to excess profits tax, the individual may with logic be exempt. So far as interest from bonds is concerned, it is plain that, so long as the individual is accorded a deduction of 7 to 9 per cent upon his invested capital, the inclusion of bond interest among the other items of taxable income or profits would be fruitless. The Treasury is better off with interest omitted from income and principal excluded from invested capital.

And yet, a doubt persists. Is a scheme of taxation sound which imposes heavy taxes upon the salaried man, or the man who stakes his time and money in the hazardous game of business, and yet shields the man who lives upon the income from his capital? Here are three men, each with an income of $100,000 a year. A has little or no capital, except his brains and technical equipment which will disappear at his death. He is taxed. B puts $100,000 in a risky business which, at the present, pays generously. He is even more heavily taxed. C inherited two and a half million dollars from his father, invested perhaps largely in state, municipal and federal bonds. He pays little or no tax, local, state or federal. Speaking generally, a given income backed by a very large amount of capital ought, it might seem, to be more heavily taxed than the same amount of income backed by a small capital. Yet our excess profits tax, in company with a majority of such taxes in other countries, proceeds on a different principle. "To him that hath shall be given, and from him that hath not shall be taken away even that which he hath."

When a suitable opportunity occurs Congress should, I believe, impose a differential tax on "unearned" income. This would remedy what seems to be a marked defect in our existing scheme of federal taxation. At the same time income derived from personal exertion should be given further study. Corporations already have the right to deduct the salaries of officers. The same right should be given to partnerships and sole proprietors, although the estimated salaries would have to be "reasonable."

III

The line of thought which we are here pursuing leads inevitably to a challenge or criticism of most direct taxes imposed upon business or the business unit. Let me illustrate. Here are two corporations, each with the same capital and the same net earnings; but corporation A is owned by a large number of small investors (working men and mechanics perhaps), while corporation B is owned by three millionaires. Drastic taxation on the profits of A and B will have very different effects upon the two sets of stockholders. The mechanics and working men who jointly own A will be deprived of extra war dividends which they may really need to meet the increased cost of living; whereas the owners of B will merely be deprived of unnecessary luxuries or the wherewithal to make new investments. The challenge or criticism under discussion amounts then to this: that an income or excess profits tax of any variety upon a business unit is illogical; that its principal incidence and burden are upon the stockholders; that there may be relatively strong stockholders in weak corporations and very weak shareholders in strong corporations; that so far as possible, we should avoid the intermediary, the agent, the go-between, and employ only the personal income tax. At the basis of this criticism will be found an assumption, conscious or unconscious, that all direct taxes are to be judged by the ability standard—to be accepted or condemned according as they conform to, or depart from, the principle of taxation in accordance with ability to pay.

At this point it is pertinent to note that the difficulty under discussion is not to be remedied by any substitution of the war profits principle for the excess profits principle, of the English for the American method of computing the tax.

Here are two corporations, each with $1,000,000 capital and each earning $300,000 a year during the war, but whereas corporation X earned $200,000 in the normal, or average year before the war, corporation Y earned only $80,000. Under the English law, with its pre-war income standard, corporation Y would be taxed very much more heavily than corporation X, which is in reality the stronger corporation. Both corporations earn the same amount during the war, but the one which was more prosperous in the past, the one which has accumulated the larger revenues, the larger surplus against a rainy day, would, under the English law, pay the

smaller tax. As a matter of principle, neglecting the practical difficulties of applying the capital standard, it is difficult to see any superiority in the English method of war profits taxation. Does pre-war prosperity establish just ground for exemption or immunity during the war? Do not extra war profits added to a high level of prewar profits create an unusual capacity to bear taxes, rather than the reverse? If you and I are equally prosperous today, but I have been prosperous much longer than you, is my longer prosperity sufficient reason for levying a smaller tax upon me than you?

As a matter of theory, and in the average or normal case, I believe that these two standards, the income standard and the capital, are essentially similiar. In the long run, the real invested capital depends upon normal earnings. Our illustration of corporation X and corporation Y was in fact false and misleading. It represents an impossible case. If corporation X had enjoyed profits of $200,000 a year as a regular and normal thing before the war, its true invested capital could not, except by accident, have remained at $1,000,000. Its capital assets, tangible and intangible, would have come to be worth $3,000,000 or more; they could have been sold for that amount; and individual investors would have bought stock on that basis. In the normal case, the income and capital standards are, when properly interpreted, practically the same.

But we must get away from the "original investment." Where mature and well-developed corporations are concerned that concept has little meaning. The original investment has no permanence. It changes inevitably. Durable assets, such as land and buildings, depreciate and appreciate; and these variations may at times be taken up on the books and they will certainly be taken into account in any case of sale or consolidation. Intangible assets are built up and in turn disappear. The true capital, the true investment, changes with the shifting level of income and with future prospects based upon such income. Of course, if we take only the income of two or three years before the war, there is no necessary correspondence between such income and the true capital of the business. But what chanced to happen in the three years which preceded the outbreak of the war is not and should not be controlling in this connection. Even if we accept the pre-war profits standard, its logic requires that we ascertain pre-war earnings over a sufficient number of years to obtain a true or normal average; and over such a series

of years no industry, except a monopoly, can earn upon its true capital an abnormal rate of profits. In short, if we could satisfy in practice the logical requirements of both methods it would make little difference in the vast majority of cases whether we employed the income or the capital basis.

IV

The American excess profits tax of October 3, 1917, was passed after a stubborn and protracted legislative contest, in which one idea, vaguely called the excess profits principle, triumphed over another idea usually referred to as the war profits principle. This victory of "excess profits" over "war profits" is very significant. Its significance does not lie in the substitution of a deduction of exemption based upon capital for one based upon income. As has just been pointed out, these two methods are in the last analysis, if consistently applied, so closely related as to be almost one and the same. The significance of the American law, or of its adoption, lies in the fact that it represents a deliberate rejection of a pre-war standard in favor of a normal standard. War profits taxes must, it would seem, be short lived. An excess profits tax might, conceivably, become a permanent fixture in our financial system. Base the tax on excess of present earnings over pre-war earnings, and with each passing year the basis of the tax becomes more antiquated, more impossible. Base the tax upon excess over a fair return on the investment, properly measured to start with, and with each passing year the tax may become sounder and more equitable. The government asserts, as it were, a right to share in any abnormal or unusual profits realized by the business man. This is at once the peculiar promise, or the peculiar menace, or the peculiar scientific interest of the American excess profits tax—as you are inclined to look at it. It is likely to prove the most revolutionary development in public finance since the introduction of income taxation.

V

If the tax is to endure it must meet the fundamental criticism mentioned in the beginning, that, in common with most taxes imposed upon the business unit, it does not conform to the principle of ability to pay.

It is a shallow and narrow interpretation of this principle that

tests its every application by the effect of the tax upon the consumer; which surveys man, the taxpayer, only as one who clothes his back and feeds his body. There are many valid varieties of this great principle of taxation and among them are those which survey the taxpayer in his capacity of producer, which take the business man in his economic and political environment, which recognize the truth that the state and community stand as silent partners in every business enterprise, which make a permanent place in our revenue system for a tax designed to take for the community a fair portion of all profits in excess of the amount required to elicit the requisite investment of capital. Such a tax would be in true conformity with the ability principle; it would spare the infant industry; it would spare all industries during periods of depression; it would encourage industrial experimentation; and would lay the heaviest burden upon those who have been most fortunate. It solves, in a reasonably satisfactory way, the difficult question of finding a graduated or progressive tax for business enterprise. It may possibly supply, what is even more difficult to find, a practicable and equitable method of business taxation.

The tax contains, like most good ability taxes, a distinct element of the benefit principle. The English courts have decided that the English excess profits tax represents the state's share in the profits of private business; and the American law—by refusing to permit the deduction of an excess profits tax as a business expense of the year in which paid—apparently partakes of the same character. It is not a tax upon the individual to be judged by the sacrifices which it imposes upon him, but the prior claim of the state upon private profits which public expenditures, or public misfortunes, or the general environment maintained by the state, have in part produced. The government's claim to part of the profits, particularly in time of war, is so strong as to justify the statement that the stockholders have no claim on profits until the government has released them. When a special assessment or betterment tax is imposed, no cognizance is taken of the individual's ability to pay. For much the same reason, when an excess profits tax is levied upon a corporation or partnership, no cognizance need be taken of the tax paying ability of the shareholders. We must have business taxation because business units, as such, benefit by the activities and expenditures of the government; because they have, as business

concerns, differing "abilities" to pay; because the state cannot wait for the distribution of profits from the business source to the ultimate recipients; and because taxes levied at the business source are far less expensive to collect, and far more productive in yield, than those levied upon the individual partners or shareholders in business organizations.

VI

What I have been considering is the eminently practical problem of the future of the excess profits tax; will it endure—should it be permitted to endure after the war?

I do not pretend to give the final answers to these questions even in my own mind. But they are questions about which we should begain to think seriously. It is sometimes said that the country which imposes an excess profits tax after the war will so hamper its business as to deny it any share in the international trade of the world; in short, that it will place domestic industries at a disadvantage in competing with foreign industries.

Whether this criticism be sound or unsound depends upon many factors, among which must be included the relative burden of all taxation in this country as contrasted with foreign countries; the equity and care with which this and other taxes are formulated and administered; and most of all upon the truth of the theory upon which the tax rests. It is either true or not true that the success of business enterprise depends, in part, upon the helpful participation of the state. This is either genuine truth or humbug. If it be a genuine truth, business can afford to pay for the assistance of the state. If it be merely false and hollow rhetoric, American business enterprise will fall before foreign competitors which do have the real support of their respective governments. In general, what business fears is not heavy taxation, but unjust and discriminatory taxation, careless taxation, bungling attempts to do the impossible, inconsistent taxation, the unlike treatment of like business situations.

Such a tax might serve appreciably to allay hostility to big business by making the people a partner in the success of big business. As pointed out several years ago by Henry C. Adams, such a tax fits in harmoniously with the policy of rate regulation or price regulation. We shall probably have more of such regulation as time goes on; and this regulation must, in all probability, be accom-

plished through general rules which, adapted to the less favorably situated producers, yield excessive returns to the more favorably situated producers. Under such circumstances, a tax upon excess profits makes the results of price regulations more equitable and more attractive. Some such device as this would appear to promote individualism and private industry. Not only land sites, as Henry George emphasizes, but other commercial and industrial opportunities differ enormously. We cannot give to each industry the same opportunities of location, proximity to markets, good shipping facilities, good credit institutions and good government; but we can make inequalities a little less by imposing a tax upon the differential product—upon excess profits. Conceivably then, the excess profits tax may assist materially to promote that equality of opportunity which is as necessary to good business as to good citizenship.

Lack of productivity will probably prove the gravest weakness of the excess profits tax as a permanent part of the tax system. In normal years we cannot expect a tax upon supernormal profits to yield the enormous revenue which we expect to derive from this source during the war. And yet, it is probable that even in lean years the tax would supply a revenue altogether worth while. In our vast country it seldom or never happens that all sections and all industries move together. When there is drought or financial depression in one part of the country, other sections enjoy abundant crops and prosperous business conditions. Where an epidemic prevails the doctors, at least, do a thriving business. There will always be some excess profits to tax.

But if the tax is to succeed, we must solve this problem of establishing a sound normal basis from which to measure the excess. In determining this normal datum line we can, as has been stated, use either past income or invested capital; indeed the difficulties are so great that we should make use of both. It would be theoretically possible, for instance, to take the income for a considerable number of years, exclude the abnormal years and accept the remainder as our datum line. But even in this case we should have to make allowances for the increase in capital; and for this and other reasons, the United States, in contrast with most of the other thirteen or fourteen countries imposing the excess profits tax, prefers to start with the capital basis.

Even with this basis we are forced to rule out those capital assets which are the product of abnormal conditions. For instance, no serious consideration was ever given, or could practically have been given, to the proposition that the capital basis of the tax should reflect the abnormal profits earned during the war.

In getting rid of abnormal capital items, however, many of those interested in this subject have gone to the other extreme. They believed that capital should be taken or valued as of the time of original investment. Curiously enough, it may be said parenthetically, this principle is adopted in the English law in so far as that law makes use of a deduction based upon capital. The difficulties engendered by starting with the original investment are enormous. Some corporations are fifty years old or more and the exact amount of cash or tangible property paid in, and the circumstances surrounding such payment, have disappeared in the mists of time. On the other hand, many corporations have gone through formal or genuine reorganization within the past few years. Some old corporations have written upon their books the appreciation which has taken place in their real estate and other property. Other old corporations have not done this. Some corporations have so handled advertising and similar costs that they stand on the books as capital assets, designated "good will," "trade-marks," and the like. Many other corporations, having brands or similar intangible assets of great value, have written off as current expense the advertising and similar expenditures made to develop or create these intangible assets. Some corporations have bought good will for a very large sum and within the next few years have written it entirely off their books. Other corporations carry the original expenditure as a capital asset. To go back to the original investment in each case is to treat essentially like situations differently; to introduce distinctions so capricious as to be maddening; to discriminate in a way that raises the gravest questions concerning the constitutionality of such treatment.

My own belief is that the most practicable treatment yet suggested for this situation is a valuation of capital assets as of some date, say January first, preceding the war. We must get rid of the war, that greatest of all abnormalities. To some degree this solution has been utilized in the capital definition adopted in the Excess Profits Tax Act of October 3, 1917. Tangible property paid into a

corporation for stock may be valued with some reservations as of January 1, 1914. How far under this statute actual valuation may be substituted for original investment; how far Congress intended this substitution to be made and how far the courts will sustain a rigid insistence upon original investment values, are grave questions which cannot be answered at this time.

This much may be said, however: we must start with a practicable and reasonably equitable determination of normal capital value. Until this foundation of the tax has been built, and built upon rock, the excess profits tax can only be a temporary makeshift.

THE WAR REVENUE ACT OF 1917

By Daniel C. Roper,
Commissioner of Internal Revenue.

This article is written by me, not as Commissioner of Internal Revenue, nor as tax collector, but as a student of our mutual problems. I shall not undertake to recite in it all of the problems which confront us, in administering this law. Dr. T. S. Adams, who is so ably assisting in this work, has prepared for this issue of The Annals an excellent article on this subject, as have also many other writers.

I shall not afflict you with the burdens that I see ahead in the way of administering this tax. To do so would be unkind. This may be illustrated by a little experience some years ago in a southern town. A tourist train rolled in to a town of some 2,000 population. One of the tourists, jumping off of the car, approached an aged colored man and said, "Will you tell me the population of this town?" "I don't know as I zackly understand what you mean, sir," the old man replied. "How many people live here, then?" "Well, sur, I don't know zackly,—'bout a million." The old darkey probably saw the future development of the town. This is quite analogous to the volume of problems which will confront us in the course of the administration of the new War Revenue Act.

This act is now the law of the land. It is a fundamental principle of democracy that the people shall tax themselves. The essential strength of democracy, especially in the time of war, lies in this fact. Through the passage of the War Revenue Act of 1917 the people by well-nigh unanimous vote of their chosen representatives in Congress have levied upon themselves additional tribute of substantially two and one-half billions of dollars to meet the war needs of their forces on land and sea.

For months the country and the Congress were divided in opinion as to methods of raising the money which all agreed was necessary for the common defense. The legislation enacted by Congress for financing the war has definitely settled all such differences. The greater part of the huge total sum immediately needed is to be raised by the sale of liberty bonds, thus allotting to our pos-

terity its fair share of the burden and deferring to more settled times its final distribution. The first two issues of liberty bonds, aggregating eight billions in amount, have been taken by the people with an alacrity that speaks the patriotic determination and enthusiasm of a united country and must reassure our defenders as it disturbs our foes. But the financial provision through the sale of bonds is not adequate to the needs of our great cause. In addition to this it is essential to our success and to the proper support of our sons who are risking their lives that the people of the United States immediately pay a large sum into the country's Treasury in the form of a liberty tax. This is no less essential than that of the liberty loan which this tax underlies and supports. The liberty tax represents that portion of the burden which we assume and discharge for ourselves while the liberty loan represents that portion of the burden which it is only fair for us to remit to those who shall come after us.

The law providing for this liberty tax has been determined upon by the people's representatives in Congress. It is law, but the actual administration and collection of the taxes is one of the greatest war tasks now confronting the people and the government.

This is no time to cavil at the manner of amounts of government expenditures. The government as well as business must gradually become adjusted to new conditions. Congress has acted, certain agencies have been charged with the duty of administering, others with the duty of expending. Both must act speedily and cooperatively for the enemy is at the door, liberty and its institutions are in imminent danger. The price of its defense cannot be excessive as related to the lives and happiness of our people.

This is the greatest tax levy ever undertaken in the United States. In more magnitude it surpasses any previous draft on the treasure of the people. It exceeds all others in the wide range of its provisions and in the variety of its incidences. But the purpose for which this tax is being raised is the most serious to which the Republic has ever been devoted. The need for every dollar of return due under the law is the need of continued national existence. And at the same time, the necessity of retarding or disturbing as little as possible the economic forces and operations of production and distribution was never before so imperative as now.

The problems of administering the War Revenue Act of 1917

are receiving most earnest consideration by the Secretary of the Treasury and his assistants. A policy has been outlined and the general principles to be observed have been established. This policy is to collect from every citizen the full amount which Congress has determined to be his just contribution to the nation's need with the least possible inconvenience to the citizen and the least possible disturbance to business and industry. Any other program or policy of administration would injure our cause and help the Kaiser.

There must be a way to administer this law constructively and this highway we will earnestly seek. It is essential to proper administration that each taxpayer shall be able to obtain accurate information as to the amount of tax due by him and the time, place and method provided for its rendition and payment. This is indispensable because the law puts upon the taxpayer the burden of making the returns upon which his tax is measured. It is likewise essential that each class of taxpayers be treated with intelligent regard for the circumstances by which they are personally affected, or which affect their businesses or avocations and to the end that the machinery of adjudication and collection be widely and uniformly diffused; that the correct construction of every part of the law be authoritatively determined and all doubts as to such construction be as far as possible removed; that the willingness of all classes of people to aid in the scrupulous observance of the law and their eager desire to be of service in helping to win the war be organized and utilized to promote the uniform and universal enforcement of the law; and that each citizen be given the utmost assurance that no other citizen will be permitted in any wise to evade the law which he himself is fully and loyally complying with.

To attain these ends is a task of organization and administration. The first step necessary is the reorganization of the Bureau of Internal Revenue at Washington. A veritable transformation is required to expand this branch of the Treasury Department to assume the greatly increased burden laid upon it by the War Revenue Act. For this purpose a new alignment of its forces has been projected, additional divisions have been created, responsibility and authority rearranged and defined and preparations made for a large increase of its personnel. The need of these things is forcefully evidenced by the fact that for the year 1918 it is reliably estimated

that there will be 6,350,000 income tax returns made to the bureau as against 780,000 for the year 1917. From its organization in 1862 until the passage of the corporation tax law in 1909 the bureau was constructed for collecting the taxes on fermented liquors and tobacco, requiring more of a policing procedure than is necessary now. We now need men especially trained in business administration and accounting lines—men who can intelligently approach and wisely deal with our complicated society. One phase of the reorganization of the bureau is of especial significance in this connection. Steps will be taken to bring the tax gathering machinery into closer touch with the best unofficial thought and with the public generally. It is hoped to accomplish this by the appointment of certain business men as advisors to the Commissioner of Internal Revenue on business conditions and by the creation of an office in the bureau to be known as Supervisor of Taxpayers' Coöperation.

On the twenty-fourth of October the Secretary of the Treasury announced that he would appoint certain persons as excess profits advisers on business conditions to assist the Commissioner of Internal Revenue in construing the excess profits provisions of the War Revenue Act. These will be men of high standing as economists and directors of business. They will bring to the administration the viewpoint of the taxpayer. It is not intended that these persons shall exercise administrative functions. Their task will be purely advisory. The earnest desire of the administration is that the excess profits tax may be so correctly and discreetly applied that each business enterprise may render to the government the full amount due, without embarrassment and without abatement of its productive power. This also is in recognition of the accepted necessity of treating special conditions in a special way.

The legal review advisers, the proposed appointment of whom was announced by the Secretary of the Treasury, simultaneously with that of the excess profits advisers, will be recruited also from unofficial life. Eminent representatives of the American bar will be given opportunity to give their service for advice to the Bureau of Internal Revenue. The new law presents many problems of construction and interpretation which are fraught with grave consequences to the public revenue and to business. These advisers will be an assurance to the country that these problems will not be dealt with in a narrow way, but that they will be solved in the light of

the broadest and most constructive legal knowledge and experience available.

The third new agency in the organization of the Bureau of Internal Revenue for following up this intimate association of business and government in the administration of this war revenue measure is the Supervisor of Taxpayers' Coöperation. His task will be to keep in touch with the public and collect and assimilate for the department business suggestions and also to diffuse correct interpretations of the law and administrative regulations through all possible channels to the taxpayer. In an informal way, a nation-wide organization of coöperation will be created. In furtherance of this plan the formation of local advisory committees will be encouraged through which it is hoped to enlist the voluntary assistance of patriotic citizens. This service must be purely unofficial and voluntary. As stated, these local committees will be composed of citizens volunteering their services to aid in facilitating the selective draft of wealth. It is proposed that these shall make a special study of the law and of the published aids furnished them from Washington. They will give information and advice to the taxpayers in their communities, direct local propaganda for coöperating with the government agents in the collection of the liberty taxes and keep the department informed regarding the general administration of the revenue law.

A most wholesome sign of the unity and patriotism of the American people is the manifest widespread desire to find a way in which the citizen may help the government in this critical hour. Thus it is the purpose of the government to invite the coöperation of all patriotic citizens in the full and fair performance of the great task of fairly administering and collecting the war tax—in that way to afford the citizens whom circumstances may require to remain at home an opportunity for real service in the great cause for which their sons and brothers are fighting. May we not hope to make the liberty tax, by reason of its patriotic purposes and by reason of the fairness and justness of its administration, a popular tax even as the liberty loan has been made a popular loan? As well stated in a splendid editorial in *The Saturday Evening Post*, "One of the finest things in the Civil War was the way in which citizens stepped up and paid their income taxes when they could have dodged them if

they had wanted to do so. We expect that chapter to be repeated in this war."

The literature which comes to me from this Academy is most instructive and effective and as the administration of the war tax law must largely be a campaign of education I earnestly solicit the continued sympathetic attention of your body to the important questions arising under it. It is probably the most important opportunity for patriotic endeavor now presented to you. Your country needs the character of advice which you are especially trained to give as much as it needs the service of the trained soldier at the front.

LIQUIDATION TAXES

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It is indicative of the advance of economic thought that in the present war its main controversy should turn on the relative merits of taxes and loans. There are few economic principles but which are put in a fresh light by the discussion which bids fair to make as important changes in economic theory as did the famous rent controversy during the Napoleonic wars. This older discussion emphasized the presence or absence of an unearned element in income. Land incomes were put in a separate class with a resulting pressure to relieve industry from taxation by putting the burden on land revenues. The sweep of free trade doctrines could hardly have been as complete as it was if the rent controversy had not preceded it. We may expect a like transformation of economic doctrine if the relative merits of taxes and bond issues are settled as permanently as were the issues involved in the discussion of rent and free trade. Every great fallacy in thought discovered and removed makes possible new adjustments not only to nature but also between the various social groups on whom industrial efficiency depends.

The evils of taxation, however, do not make bond issues good nor those of bonds make taxes the only way to meet national burdens. Earlier controversies revealed that protection was bad without proving that free trade was good; that paper money made a disastrous form of inflation without showing that other expedients did not have like evils; that rent was an unearned income without giving an economic justification to kindred forms of income. In each case the advance consisted in barring out one expedient without increasing the respect for the others. I anticipate a like result in this case. I doubt if the opposition to taxation will be reduced by the controversy but I believe that in the end bond issues as an expedient to carry on a great war will have no better standing than paper money now has. We must learn to get on without bonding just as we have learned how to promote industry without protection or to meet urgent obligations without a resort to paper money. Nor

do I wish this paper to be viewed as an eulogy of taxation; but I desire to show that large bond issues are a fatal expedient, something that we cannot use without the danger of social disintegration. Beyond this I wish to show that its reputed advantages are illusory, destroying and not conserving our resources. It would be useless to show this if it were not accompanied with positive information as to how to devise an adequate tax system. If we do not want the public to use patent medicine we must provide sane remedies. In the same way the opponent of bond issues must show how extraordinary expenses can be met without their use. The present task is to devise a system that will meet the need for revenue and yet avoid bond issues to the same degree that a sound financial system avoids paper money

OBJECTIVE TESTS

Economics is now becoming like physical science in that only objective tests are used. So long as economists asked how do men feel about certain measures no reply could be made but to test these feelings, or to appeal to certain supposed innate principles at the basis of human psychology. There was no way to determine these feelings except in small communities composed of like individuals. The method used was to assume a typical man and to get at the assumed advantage or disadvantage by multiplying the sum of his feelings by the number of the people concerned. Such a method fails in a great nation with many classes and many grades of income each resulting in certain feelings peculiar to his class. This complex cannot be summed into a whole because the advantage of one group may arise from the disadvantage of another. We thus have society split up into a number of classes each with its own measures and each assuming the falsity of other standards than those it uses. From this confusion there is no exit except by discarding all subjective measurements and by proceeding according to objective tests such as physical science employs. Great advance has been made in recent years in collecting the data by which objective tests can be applied. We are now in a position where objective tests will produce better results than subjective methods. What we feel and what we know in many fields clash. Only as we suppress the feeling and permit the facts to guide can we hope to attain the objective adjustment on which the permanent prosperity depends. We may

blunder along in times of peace because the cost of bad action is not severe enough to strangle the life of a nation, but the drain of a war is too great to permit of the waste which our feelings in times of peace encourage. In war the nations or group of nations will win which succeeds in preventing waste. We may outrage our feelings without serious loss if we conserve our resources. The older subjective economics thus fails to solve our problems. It is the newer objective science to which we must resort.

THE PHYSICAL COST OF WAR

The first problem to face in this objective way is the physical cost of the war. We are so used to figure in terms of values that we seldom think just what these values stand for. Values are estimates based on income and grow or decline as income is altered. If the return from property is estimated at 4 per cent instead of 5 per cent we immediately assume we are to have a quarter more wealth. If a property yields $5,000 instead of $4,000 we immediately assert that we are correspondingly more wealthy. Our estimates which make us as a nation worth two hundred billion dollars are of this nature. No one has made an actual investigation to find what property we have. We estimate its amount from the revenue it yields. But mere values cannot carry on a war. War destroys physical goods and their amount fixes the contribution which each nation may make. The cost of the war is the destruction of these goods, losses for which fresh labor is needed to replace. We may through inflation think we are getting rich because values rise and yet we may be losing the basis on which our prosperity depends. On the other hand we may lose much that hurts our feelings, and yet be as capable as ever of prosecuting the war. We often lament the loss of nonessentials more severely than that of the more substantial elements of personal welfare. Our estimates must conform to the latter standard if we would know what are the real losses which the war imposes. It has recently been reported that the crown prince of Germany goes about with rags in his tires because of the lack of rubber in Germany. I do not know how the crown prince feels about this. Certainly our papers make much of the supposed loss of dignity which it imposes. But if the story be true the physical burden which the crown prince imposes on Germany is a slight one. He might estimate his injured feelings by the million but in physical

terms they would not be worth noticing. It is also said that the ladies of Germany are now compelled to wear wooden shoes because of the lack of leather. Here again we have a severe subjective loss, due to the imposed degradation, but measured in objective terms the wooden shoes place but a slight burden on the national resources. A million iron crosses have been distributed to German soldiers. The joy of this may be great but the physical cost is slight. In contrast it is said that in Paris the demand for jewelry never was greater than at present. If the Germans take their reward in iron crosses while the French demand gold and precious stones the one has a slight physical burden of the war while that of the other is heavy. The physical cost of supporting the German people is probably not over 60 per cent of what it was before the war. This leaves about 40 per cent to be devoted to military purposes. A long war of the present magnitude could be indulged in on this basis if the civil population will put up with their present sacrifices. War is a shifting of expenditure not its increase. In contrast to this the physical cost of supporting the allied nations has probably increased. Their war burden is thus an extra burden that cuts in on physical resources. The increase of the physical cost of supporting America's population is perhaps 20 per cent greater than before the war. We think ourselves worth forty billion dollars more than five years ago and rejoice that we are free from debt instead of owing billions to foreign investors. But this estimate of values is subjective. In proportion to population our physical output is not much greater than it was ten years ago.

Where War Burdens Should Rest

It is the misfortune of discussions of taxation that investigations start with the wrong problem in mind. That men feel badly when taxes take from them their income may be taken for granted but to measure these feelings is an impossibility. Discussions of justice and morality likewise involve subjective elements which no one can measure. They are matters of feeling and it is inevitable that each one should view his burden in the light of his education and class interest. In a complex society like ours this leads to a useless wrangle about the shifting of taxation making taxation a distributive problem with all the uncertainty in which every problem of distribution is involved. Good taxes thus become those which

somebody else pays. We should not tax the laborer because that reduces his standard of living. We should not tax capital because that would limit production; we should not tax profits because that would reduce the motives for activity. And so it goes, with the result that our revenues are inadequate to meet expenditures. It only puts off the evil day to issue bonds, for in the end new taxes must be imposed to meet the increasing deficit. It is therefore a new attitude which is needed and not a further elucidation of our feelings and antipathies.

Taxes are burdens on some one's income. What principle should we employ to impose them? If objective instead of subjective tests are to be used there can be but one answer: ***taxation should fall on advantage.*** It is what one person has which others have not that should bear the burden when taxes are imposed. Every invention, every change in production, every increase of human energy, every economy in consumption creates a surplus which abides. This may be reserved for public benefit or be permitted to pass into private hands to be used in personal consumption. An increase of taxation means a larger use of this fund for public purposes. In times of peace but a small part of this surplus is taken for national uses. In this country not more than 10 per cent has been demanded; but under new conditions especially in large cities a greater proportion is needed by the public. The war has thus forced the nation to face a problem which time would in time have forced on public attention. Instead of 10 per cent, the nation now needs 30 per cent if revenues are to meet current expenses. Some objective measure of advantage must be found by which the burden may be so distributed that production may be interfered with to the slightest degree. Our feelings and class prejudices must be set aside and the facts faced.

The Measure of Advantage

The Ricardian theory of rent was the first to state the difference between earned and unearned income and thus to show that land rent was a surplus to which the recipient was not entitled for any legitimate service. This fund has rightly been held as a fit object of taxation for on it taxes may be placed which will not be burdensome to industry. So far good, but a curious intrusion of a psychic fallacy gave it a one-sided interpretation which permitted a sound

doctrine to be used for class advantage. It was assumed that the subjective cost of labor equalled the pay it received and thus all the surplus of society went to the landlord as rent. The wage fund theory was responsible for this view but its repudiation by later economists has not yet led to the broader view which newer doctrines permit. I shall make no attempt to measure the feelings of the worker of today. For aught I know he may feel worse working eight hours than his forebears did working twelve hours. He may also get less pleasure out of meat and bread than did his ancestor from the meager diet which earlier times permitted. But objectively considered he does share in the surplus modern industry has created and this fact, not his class feelings, should be considered where taxes are laid. But the error here is a slight one in comparison with the type of reasoning other classes use to justify their income.

It is assumed by the capitalist that he has a subjective pain in saving which corresponds to the rate of interest he receives. He asserts that the return on typical investments yield no surplus above the pain of abstinence and that therefore his income should be exempt from taxation. But if we use objective measures we see that the possession of capital exempts him from much misery which other classes are forced to endure. When we see the acts and the pleasure of capitalists it is hard to reconcile their plenty with the existence of a pain not revealed in their looks. Objectively the possession of capital brings pleasure and a freedom from evil. These facts and not their hidden ills should be considered by the government when it is deciding on public policies involving sacrifice. The shortcomings of the subjective standards are equally evident in the field of income. The larger income does not imply increased exertion or greater sacrifice, but a better education, better health, more energy and more fortunate conditions. Objective evidences of suffering are absent and instead there are many evidences of exemption from life's ills. Income is thus the measure of advantage and not of effort, of situation and education and not of heredity. If this income is due to education a pleasant school life replaces the early toil of those deprived of schooling. If the difference is in heredity the gains are due to what happened ages ago and not to the recipients of present income. How can a white man claim that his superior income is due to his personal exertion as compared to an

individual of the colored race? His advantage is as much unearned as is that of the landlord who lives off the proceeds of a favorably situated lot.

In the same family or in the same racial group the superiority of income due to the presence of superior traits is not the result of what the recipient has done but of his good fortune. Inheritance is not an even result going alike to all members of a family or group. The Mendel laws of unit inheritance shows that traits may be recessive in particular individuals and dominant in others. Two brothers may thus have radically different traits although their ancestry is the same. The superiority of the few over the many is a valid inference of the Mendel laws. Only a few have an abundance of those traits which make for financial success. In a rough way it may be said that of four children with like inheritance one will be superior, two mediocre and one a failure. This is about the proportion of strong and weak which we find in actual experience, thus giving a practical verification to the law in question.

To make my point I need not show in just what proportion the income of the nation will be distributed among these groups. The essential point is that the traits of the superior individual are not due to his exertion but to his advantage. This may be in education, in position, in race or due to the operation of Mendelian laws but after all it is advantage and advantage should be taxed. This does not mean that A who has an advantage has no better claim to it than B who is without this advantage. It is not the distributive problem that I am trying to settle. The real problem is what claim has the state to the income due to the advantages which the favored persons or classes have? There can be but one reply. The state represents the past and the future; the present recipient of income only the present. His superior income is due to the past of which the state and not he should be the heir. The permanent needs of the whole community are thus placed above that of particular persons and the future in which these individuals will not participate gets the advantage of the accumulations of the ages which become objective in present income.

In the use of these objective standards only two classes should be recognized; those with a deficit of income and those with a surplus. Ideally the line dividing the two classes is that income which permits the continuation of family life under normal conditions

coupled with a complete nutrition of all its members. It is not enough to preserve individuals; we must preserve the family. This means a childhood free from toil and an old age without care. Couple these facts with the cost of complete nutrition for the family at all times and we have the sum that divides a life of deficit from one of surplus. This line is not hard to determine for we have the facts that show the cost of family nurture. Eight hundred dollars represents a minimum as prices were before the war. It is certainly not less than $1,000 at the present time. Those below this limit lack in a physical ability to contribute to the war. Those above the limit have a surplus they could spare. As against the claims of the state no class sharing in this surplus has a special claim to consideration above other classes. All families below the accepted income should be regarded as the nation's wards and treated accordingly. Were we to give them more instead of depriving them of what they have, the national surplus would be increased and the net power to carry on a war would be enlarged. By this I do not mean that these struggling families cannot be made to contribute to the support of the war. But their contribution must come through increased efficiency and not through imposed burdens. Just those things which we should have done in times of peace but neglected to do should be done on a large scale in war time. We should reduce sickness, cut down the hours of labor, have better sanitation and teach new ways of living which will promote economy and efficiency. All these measures and many more like them can be suggested which will increase the national surplus and thus enable the prosperous to bear more readily the burden of the war. But the taxation of the nation's wards is always detrimental and gives no compensations which enable others to carry on the war.

Nor do I mean that we should not encourage thrift and help people below the normal income to shift their consumption in ways that permit saving. This we would do in times of peace and should do more persistently in war time. But the means of doing this are misunderstood because of a lack of appreciation of the motives of the poorer classes. There is among them but little appreciation of distant welfare. The pressure of immediate wants is too great to inculcate a vision of the future happiness but there are strong motives to provide for such objects as they visualize. A poor family will pay high rates to insure a proper funeral for a dead

child although no motive exists to educate the living child. Much saving takes place to bridge over epochs of unemployment and some to provide against sickness. A little higher up in the scale of living the desire to own houses is an effective motive causing building and loan associations to thrive. In country districts the ownership of farms makes an appeal which is effective so long as land is of low enough a price to permit a purchase. But all these motives fail when future weal stands alone. In a 4 per cent railroad loan a farmer will not invest and the lack of motive is still greater among the industrial workers whose saving motives are more difficult to arouse. But this does not mean that these people may not be appealed to by a war loan. The rate of interest, however, must be much higher than that now offered. The lesson of the war will show that the "big stick" disguised in forms of patriotism will not increase saving above its present amount. High rates of interest would do this with the effect not only of helping to carry the war to a successful close but of transforming a large part of the nation's wards into normal citizens. But this change should be voluntary appealing to motives which the nation's wards understand. It is their psychology and not that of the upper classes that we should study. If this is done the primary burden of the war must fall on those with a surplus income who now have their wants supplied above the minimum of well-being.

It is this objective surplus and not profit commercially considered that must be found and measured. The subjective elements in older estimates made the costs of production seem larger than they are. If I pay thirty dollars for a suit of clothes I pay for certain material which must be replaced and for certain quantities of food and shelter which workers require. But much of my thirty dollars goes to compensate the feelings which producers have. This sum need not be paid or its payment may be delayed. The owner of horses estimates their cost by the food he gives them and by the cost of the care involved in their keep. He does not regard the feelings of the horse nor put their equivalent in his estimates of cost. If from day to day they show no deterioration in objective appearance he regards the sum given for their support as his expense. The same is true of a population. The physical cost of a people is the amount needed for bodily welfare. The difference between this cost and the output of industry is the surplus.

Whoever shares in this has something which he might give up without reducing industry and this amount fixes the limit of taxation. When we realize this we can see why Germany stands the burden of the war so well. The people grumble and occasionally revolt, but there is no reason why this burden should not be borne for years if the will of the German people is equal to the sacrifice demanded. What they have done we can do on a larger scale because our surplus measured objectively is much larger than theirs. When it is asked can the proposed war expenditures be borne by the American people there is but one answer to be made. They can be borne and even more than the proposed ten billions can be set aside without cutting in on the sum needed to repay physical costs. But if it is done there must be no waste nor any compensation for outraged feelings. If we do what we can and avoid what we should we can bring the war to a successful close.

Many contend that in some way a part of the burden of the war may be shifted to future generations. To them the advantage, why not to them the cost? The difficulty in this solution is that the cost of war is in present goods. It is what we have which must be given for war ends and not what our descendants may acquire. War is a consumer whose needs cannot be postponed. The soldiers are preferred consumers, who must be cared for better than before. It is only the residual left after the war needs are supplied which the public can have. War thus forces a transfer of the social surplus from those who now enjoy it to those engaged in military operations. Each year of the war must therefore square its own accounts unless at the beginning of the war there is a stock on hand which may be used for the initial expenditure. Before America entered the war the accumulated stock of the world had been used up. Our problem is thus a simple one. We must save from ordinary consumption enough to supply the needs of our army. This reduced consumption may be forced, or voluntary, and the two methods of financing the war hinge on the difference. Forced saving operates through an increase of prices. The consumer has to pay more for goods with the same or a reduced income. He must therefore contract his consumption. The high prices make profits and the government borrows the net gains of the profiteer to carry on the war. Forced saving by this process turns over a part of the people's daily consumption to the recipients of high prices. What the people save is

thus given to a privileged class and they loan it to the government.

This is the essence of carrying on the war by means of loans. The people pay for the war by their reduced consumption, the benefit of which goes to the profiteer. In the end the people pay for the war a second time when they redeem the loan through future taxation. The people thus make additional burdens for themselves at some future time. *War loans are war profits.* They are the gains which favored individuals make from the war and do not in the slightest way reduce the burden borne by the people. This is not a new doctrine but one often explained by economists. But sound economic is lost sight of in the stress of a financial situation and old fallacies blossom forth with the freshness and vigor of new creations. If the high prices were occasioned by an increase of paper money, the advocates of it would have to blush for their logic, but when the same inflation is produced by a bond issue a quibble is possible which permits a flood of new argumentation over a point long ago settled. In any real sense inflation is an elevation of goods above their physical valuation. One can readily see that an increase of paper money deceives people as to their real possessions and entices them to expend above their means, and thus causes an overconsumption which brings on a crisis. Bond issues have the same result in another way. At a time when wealth is decreasing it seems to be increasing and thus induces people to expend lavishly when their consumption should be curtailed. We are said to have had two hundred billions of wealth at the beginning of the war. The government spends twenty billions leaving one hundred and eighty billions. The public instead of seeing this and acting accordingly add the twenty billions of bonds to their wealth as though it were an addition instead of a loss and call themselves worth two hundred and twenty billions. This is a deception like that of paper money inflation and equals it in its bad effects. Did this doctrine deceive only the common people it might be put up with, but editors, bankers and government officials are equally carried along with the current of popular thought. Our national income before the war was estimated at thirty billions. A member of the Federal Reserve Board recently said it was now fifty billions. Just how the destruction of the war could increase the income of the nation by a half he did not explain. It is plain he was adding in our losses as though they were

a gain and thus deceiving himself as to what our real income is. This attitude is so general that it cannot but encourage the opinion that the war can be carried on with a profit and hence permit of an increase of consumption at the very time when a sharp contraction is the only means of saving the nation's credit. Our great task is to make people realize the need of economy and this can be done only by saner estimates of the effect of the war on property and income. The entire amount by which value exceeds property is an inflation which can be cured only by the reduction of property values to their normal level. Government bonds are not the only form of inflation nor did the rise of prices begin with the war. It was going on in the dozen years of advancing prices before the war. The two hundred billions of wealth we were supposed to have at the beginning of the war really contained fifty billions of inflated values. It would have been a different task to have found one hundred and fifty billions of actual property at that time. If now we use twenty billions in war expenditure and add this amount to our reputed wealth every dollar of our actual wealth will be estimated at double its amount and be the basis of a double expenditure.

Our annual expenditure may be fifty billions but if so there is a big gap between receipts and expenditures which will soon bring the nation into financial straits. Bond issues are not a way out but a species of deception for which the public must pay a heavy price. They suffer and pay for the war; they will suffer and pay again when the bonds are redeemed. And there will come the greatest suffering of all in the financial crisis which brings inflated values back to a normal basis. Three payments and perhaps five are what this financial method imposes. Our liberties are worth the price, but before payment is it not worth while to ask how can a war be carried on with but one payment and with no inflation of values?

A good system of taxation involves more than a decision as to taxes and the machinery for their collection. The theory of values and equivalents is involved and with them must be correlated all the other mechanisms by which prices are influenced. Important among these are the restraints on consumption. We may let prices go up, and then tax people for the additional amounts needed or we may restrain consumption so that the amount saved flows into the government's coffer without an increase of price. If a third of the annual expenditure for goods must be turned over to the state, re-

strictions will effect this more readily than taxation and must be the major means by which the transfer is wrought. A prohibition of liquor traffic would reduce the demand for goods and thus prevent the rise of prices to the level they otherwise would reach. Another inroad might be made by checks to conspicuous consumption. A third of what the nation consumes has little bearing on physical welfare and on this part effective restraints should be placed.

A policy of education is needed as well as of restriction. Evolution exerts a steady pressure in changing consumption from more to less costly means of gratifying human wants. If the restriction operates to favor evolution the change is permanent. The broken habit of custom will not be restored when the restraint is removed. But if the change is a mere blocking of urgent desires then the removal of the restraint means a sinking back into an earlier state with a vast amount of increased dissipation. This relapse is too often seen after the restraints of war are removed. An epoch of dissipation has a train of evils worse than war itself. These facts make restraints and education of such importance that no scientific scheme of taxation can be made workable without their aid. On the one hand they cut down the eagerness to spend and on the other they force adjustments which abide. It is to them and not to bond issues to which the nation should turn and when they are in operation the real burden of the war can be met by taxation. Taxation is not a sham pretending to give when it really takes. It is a present burden which cannot be shifted to future generations.

Distributive problems are out of place in a scheme of taxation because they confuse the public as to the point at issue. Property owners like to talk of shifting the burden on someone else and popular agitators are likewise fond of showing how this is done. If either are right my position is unsound. If both are wrong then a view of taxation is possible which will show where the burden really lies. The whites of the south may get satisfaction out of the burdens they place on the negroes and among the latter suffering may result. But if we disregard these subjective feelings the net result is that the whites put a heavy financial burden on themselves by this repression. An increased efficiency of negroes would mean an increased income for themselves. There is no way they can shift this financial loss on other shoulders. So too employers may get satisfaction by discharging workers at will but they cannot avoid the large labor

turnover that results. Every downward pressure on workers decreases their efficiency and reduces the net surplus of industry. It is impossible, therefore, to put a burden on workers that will not take from employers more than the laborers lose.

If the prosperous must bear the ultimate burden and any attempt to shift is only at their cost it is not difficult to decide where new taxes should be imposed. They should fall on the net surplus of society, and should be proportioned to the surplus of each class or individual. The income tax seems best fitted to meet these requirements but in reality it has a defect which makes its operation one-sided. Income is a measure of immediate advantage but not of ultimate advantage. Suppose the income of a given industry is increased by $50,000. This is income and rightly to be taxed. But the presence of this income will increase the value of property by a million dollars if interest is 5 per cent. This million dollars the income tax does not reach but is as fit an object of taxation as is the original income. The ultimate advantage of an increased national return thus shows itself not an income but in increased capitalization. It is this untaxed capitalization which new taxes should reach.

If the properous object to this solution can they shift the burden on any one else? If twenty billion dollars in bonds are issued instead of the needed liquidation of values they start an inflation which produces a still greater deficit. Every financial scheme to shift the burden breaks on this rock. It produces suffering among other classes but gives no relief to the net burden of the prosperous. Every deceptive device comes back to claim compound interest. They can pay for the war once if they pay the bills as they come due. They can pay for it as many times as they please by trying to make future generations pay. An individual may escape his burden by schemes that put the burden on others. He may take his chance in a panic and gain where others lose. But these devices do not take the burden from the prosperous. The individual who avoids his just burden punishes his friends and not the laborers or the community. They will suffer but their suffering brings no relief to the prosperous. All improvements increase net income; all burdens fall on it. Were this simple proposition once understood we might face greater burdens than this war will impose and still remain financially sound. The burden of today will come back to the pres-

ent holders of income in the surplus of tomorrow. If inflation is an evil then it must be met by cutting down the national valuation of assets until they correspond to our physical possessions. We must not deceive ourselves into thinking we have two hundred and fifty billions of wealth when we have only one hundred and fifty billions, nor can we think that war is a process of increasing wealth when it merely inflates values. A liquidation tax is the only means of meeting this situation. If a man is worth two hundred and fifty thousand dollars and had one hundred thousand in debts he would not be made poorer by paying his debts and having one hundred and fifty thousand of clear wealth. The situation of the nation is this on a large scale. We spend money but instead of recognizing it we cover it up by calling our liabilities assets. To tax the nation ten billions does not differ in its ultimate effects on wealth from a bond issue to a like amount. In either case we are ten billions poorer. In one case we see it and adjust our expenses accordingly, in the other we rush on into new extravagances. A risk is run for which there is no compensation.

It is therefore the present inflated values which should be reached by any sound system of finance. A liquidation should be forced which will bring inflated values down to a level with physical valuation. People are not made poorer by this process. They are put in a position safely to take advantage of new industrial opportunities. We should therefore take a stock of national wealth and make an assessment against it. He who gets the surplus when the nation prospers should pay back when the nation is forced to enlarge its expenses. The income tax is one means of reaching this surplus but a far larger part of it goes to increased values and hence stands on the books of each individual as property. The increase of values is thus a legitimate source of taxation and it is this increase which should meet the special burdens of a war. We cannot get at the annual increase of values as readily as of incomes because incomes are regularly reproduced while it is often years before an increase of property values shows itself. A ten-year period would meet the situation fairly well and if a decennial revaluation of national wealth were made the increase thus revealed should be used to meet emergencies. If such a scheme were adopted the first assessment should be on all property for we have no ready means of distinguishing its parts. But the scheme once in operation would permit

subsequent taxation to be based on the increase of values. In practice it would work out something like this. I assume that it would be combined with an inheritance tax and that the rate of taxation is 5 per cent.

1918	*Amount of Property*	*Tax 5 per cent*
Howard Smith	$240,000	$12,000
1928	300,000	
	−240,000	
	$60,000	3,000
1938		
Estate of Howard Smith	$320,000	16,000
Howard Smith Jr. (Inheritance)	120,000	6,000
1938		
Howard Smith Jr.	160,000	
	−120,000	
	$40,000	2,000

It is plain that the net wealth of this family is not reduced by the liquidation. They are merely put in a sound financial position and thus avoid the penalities which wild financing imposes. Nor does it prevent the regular increase of values which is the legitimate result of national property. They are only prevented from overestimating the real increase and thus checked in the tendency to over-indulgence. A good financial scheme combines restriction on consumption, and a process for the liquidation of debts. Scarcely any use is made of restriction; the rate of interest offered is too low to encourage saving and the process of liquidation has not even been discussed. It is necessary to use treasury notes freely for the proceeds of taxation come in too slowly to meet current expenses. But short-time notes should not be issued until expedients are adopted to redeem them. We may properly ask the banks to carry temporary burdens but government bonds make for them bad permanent investments.

If these legitimate sources of revenue are avoided the only remaining expedient is a bond issue. The burden of the public is thus

an indirect one. They pay for the war through high prices which make profits for other people to invest in bonds. War bonds and war profits are thus the same fund and force a double payment in the end by the people. Such financing is easy for the first year, makes difficulties the second year and creates impossible conditions in the third. If we are to go ahead according to present plans it is to be hoped that German resources are nearing exhaustion. It will save us from many threatening evils.

A CRITICISM OF THE WAR REVENUE ACT OF 1917

By J. F. Zoller,
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The purpose of any tax legislation should be to get the maximum amount of revenue with the minimum disturbance to business. In considering any taxation scheme we must have constantly in mind that there are at least two classes of taxpayers which are usually taxed, namely, individuals and corporations. A tax upon a corporation, so far as a corporation can be taxed at all, is a tax upon the stockholders who own the undistributed shares in the property of the corporation. Therefore, a tax imposed upon a corporate body if excessive as compared with taxes upon business transacted in other forms or upon individuals not engaged in business, necessarily constitutes a discrimination so far as the incidence of the tax is concerned against a certain class of individuals.

Originally, all taxation was based upon the theory that the owner of the property taxed received certain benefits from the government imposing the tax. In other words, it was a tax upon benefits received in connection with the privilege of living in a civilized community. From time to time, however, there has been a growing tendency to depart from such forms of taxation based upon benefits derived from the government and to substitute therefor a tax upon ability to pay. This has been the result of a growing tendency to establish a doctrine that those best able to pay should contribute more liberally to the public burden.

It is manifest that an *ad valorem* tax upon property must necessarily be based upon the theory of benefits received and without regard to ability to pay with the possible exception that persons owning property may be presumed to have some ability to pay taxes, although we all know that certain classes of property may in some cases constitute a liability to the owner instead of an asset. Net income taxes, on the other hand, are based almost entirely upon ability to pay with very little regard to the benefits received, with the possible exception that any person deriving a net income and living in civilized society must be presumed to have received some

benefit from the government in the protection of his property from which the income is derived or received. Thus there has gradually grown up in the United States and elsewhere a tendency to impose net income taxes instead of direct taxes upon property.

An investigation of the subject shows that net income taxes have been very generally imposed in the following European countries: Austria, Belgium, Denmark, Greece, Germany, Holland, Luxemburg, Finland, France, Norway, Sweden, Switzerland and Italy; also in the Cape of Good Hope, Hawaii, India, Japan, New Zealand and Australia as well as in the United States. Not only have net income taxes probably become a permanent means of raising revenue in the United States by the federal government, but they are gradually being adopted by many of the states. For example, the state of Wisconsin for a number of years has had an income tax upon both individuals and corporations. This tax is not in lieu of any tax upon personal property, but the individual or corporation subject to the income tax is permitted to deduct from the income tax the amount of any tax paid upon personal property. The state of New York, on the other hand, has adopted an income tax upon manufacturing and mercantile corporations, which tax is in lieu of any tax upon corporate franchises or personal property of such corporations. A number of the other states have imposed income taxes as a basis of determining the amount of tax to be paid as a privilege of doing business in such states in corporate form.

The income tax in theory is probably the most equitable method of taxation because it is not imposed unless the taxpayer has secured a net income during the year and therefore should have the necessary funds with which to pay the tax, the individual whose net income is nil not being required to pay any tax for the benefits he may have received from the government.

While the theory of this tax is most equitable, its application in many cases under certain income tax laws has brought about the grossest inequality. If the taxation system of any jurisdiction is inequitable fundamentally, the imposition of an income tax in addition to all other taxes will not remove the inequalities existing prior to the imposition of the income tax. For example, a number of the states have been imposing upon corporations taxes called franchise taxes and said to be upon the privilege of doing business in a corporate capacity and being in addition to all other taxes upon the property

paid by individuals not doing business in corporate form. A franchise tax upon a corporation in addition to all other taxes upon the property is a discrimination against individuals holding corporate securities and in favor of individuals whose property does not consist of corporate securities. There would appear to be no sound reason for imposing upon corporations by any jurisdiction a tax upon the corporate franchise in addition to taxes upon the property of the corporation. If the property is fully taxed the corporation has paid a tax upon its franchise which has been reflected in the value of the property.

The method of doing business in corporate form has become a necessity and there would appear to be no reason for penalizing an efficient instrument of business. It necessarily follows that, if it be economically unsound to tax corporations upon their franchises in addition to a tax upon their property, the imposition of the franchise tax measured by net income does not in any way correct the wrong principle and such income taxes are not income taxes as those terms are generally understood, but, on the other hand, constitute a tax upon corporate franchises which under all conditions is economically unsound even though measured by net income. Therefore, those states which have imposed a franchise tax measured by net income have in no way progressed, so far as taxation is concerned, but have simply ascertained a convenient means of measuring an inequitable and unjust tax.

If it be wrong for the states to impose a tax upon the privilege of being a corporation or for transacting business in a corporate capacity it is equally wrong for the federal government to impose such taxes. It therefore seems to follow that the capital stock tax imposed by the federal government upon corporations, which is a franchise tax and is not imposed upon partnerships and individuals in competition with corporations, is inequitable and unjust and should not have been enacted. It is no answer to the argument to say that the federal government needed the revenue, because the amount of revenue which can be raised by any jurisdiction depends upon the wealth of the community imposing the tax and within certain reasonable limits the rate under a just tax law can be made sufficiently high to secure all possible revenue.

It has been the history of taxation throughout the states that the states are unable to impose, administer and collect an *ad valorem*

tax upon personal property that absorbed too great an amount of the income from such source. Therefore, the progressive states are fast departing from the imposition of any *ad valorem* tax upon personal property and are substituting therefor either a classified personal property tax at a reasonable rate fixed by the legislature or an income tax measured by the amount of net income. Those states which have made the income tax a tax in lieu of some other tax which could not be collected with full justice to the taxpayers at large have undoubtedly taken an important step in the right direction, while those states that have simply imposed the income tax in addition to all other taxes have in no way removed any of the inequalities which existed prior to the enactment of the income tax, and the only virtue in the income tax in such cases is the amount of additional revenue which has been raised as a result of the tax, and additional revenue is not always a virtue.

There would be no difficulty in the imposition of the income tax if all individuals did business in the same way so that the amount of the tax would be the same in all similar cases and the tax equally distributed over all individuals enjoying a net income. Business is transacted in this country by individuals as such and by corporations. Corporations are nothing more or less than an aggregation of individuals. Therefore discrimination against corporations is a discrimination against the individuals interested in the business transacted in such form. It may be possible to impose a tax either upon the corporation or upon the stockholders, but it is not possible to impose the same tax upon both the corporation and the stockholders without imposing two taxes upon the same individuals. If other individuals, that is, those who are not transacting business in corporate form, are taxed only once it of course is an unwarranted and unjust discrimination to tax the individuals who are transacting business in corporate form twice. Great difficulty has been experienced in imposing an income tax upon corporations without doing the injustice referred to.

It is probable that if all the earnings of a corporation were distributed as fast as they were earned to the individuals comprising the corporation then an income tax upon all individuals having a net income would bring about an equitable distribution of the tax burden and without any serious disturbance to the business conducted by the corporation. It is because such bodies do not always see fit

to distribute the earnings made that there has grown up a necessity of attempting to tax the stockholder by placing the tax upon the corporation and then permitting the stockholders to deduct from their individual incomes the income already taxed to the corporation. This method is correct in theory but has not been duly carried out in all cases. The theory has been partially worked out in the taxation of corporations by the federal government where it has been found necessary to impose a part of the income tax upon the corporation upon the theory that the earnings might not be distributed to the stockholders and the payment of the tax upon such earnings prolonged for an indefinite period unless the corporation were taxed for the year the earnings were made.

In order to avoid double taxation it is provided under the federal income tax law that for the purpose of the normal tax, individuals shall be permitted to deduct from their total net income the amount received as earnings or dividends from corporations which have been subjected to the tax upon their earnings. This is a correct theory, but Congress refused to carry it out in all cases for it did not permit under the Act of October 3, 1911, nor under the Act of September 8, 1916, corporations to deduct from their net earnings dividends received from other corporations which had already paid the tax, although such deduction was permitted under the original Act of August 5, 1909, and is also permitted so far as the additional war income tax is concerned under the Act of October 3, 1917. The Act of October 3, 1917, imposes two income taxes upon the net income of corporations, that is, it extends and perpetuates the Income Tax Act of September 8, 1916, which imposes a normal income tax of 2 per cent and then imposes an additional normal income tax of 4 per cent upon corporations.

Under the Act of September 8, 1916, as amended by the Act of October 3, 1917, corporations are not permitted to deduct dividends received from other corporations that have been subject to the same tax, while they are permitted to deduct the income from such corporations under the 4 per cent provision of the Act of October 3, 1917. The obvious purpose of permitting corporations to deduct the dividends received from other corporations under the 4 per cent provision of the Act of October 3, 1917, is to prevent double taxation of the same earnings, and is an acknowledgment upon the part of Congress that such earnings should not be doubly taxed. If this

be true of such earnings under the 4 per cent provision of the Act of October 3, 1917, it is equally true in regard to the 2 per cent provision under the Act of September 8, 1916, as amended by the Act of October 3, 1917, and there should not exist this inconsistency in the Act of Congress and this discrimination against corporations as compared with the taxation of partnerships and individuals in competition with corporations. Individuals, whether they are doing business as partners or as individuals, are permitted to deduct all dividends received from corporations made subject to the tax, and the same privilege should have been accorded to corporations.

Right here it might be well to note another discrimination in the imposition of the income tax under the Act of October 3, 1917. By that act there is imposed upon corporations an additional tax of 4 per cent upon net income, whereas the additional rate upon individuals is only 2 per cent. Therefore those individuals whose property consists of corporate securities are discriminated against when compared with other individuals.

In the imposition of income taxes generally it has been believed to be equitable to increase the rate of tax by a progressive scale whenever the amount of net income exceeded a certain amount. This is evidently upon the theory that ability to pay increases to such an extent with the increase in the net income that a flat rate of tax upon all income does not reach a proper proportion of ability to pay in all cases. The tax at the progressive rate as distinguished from the tax at the flat rate is known as the additional or surtax.

The theory of the surtax has always been that it should not be imposed or applied except in cases where the total income exceeded a certain amount. Upon this theory it is at once seen that an additional or surtax cannot be imposed upon a corporation because a tax upon the corporation as we have seen is a tax upon the stockholders and if the additional or surtax is imposed upon the stockholders by a tax upon the corporation it must necessarily be imposed regardless of the total amount of net income received by any particular stockholder contrary to the fundamental theory of the additional or surtax. Therefore, in order to carry out this correct principle, when the income tax was originally imposed by Congress, no additional or surtax was imposed upon corporations but such taxes were imposed upon all individuals regardless of the source of the income, provided the total net income exceeded a certain

amount. There is probably no way by which a surtax or additional tax can be imposed upon the corporation without doing violence to the principle that the surtax shall not be imposed except in cases where the total net income of the individual exceeds a certain amount thereby placing him in the class with ability to pay the surtax.

The excess profits tax if it had been imposed upon corporations alone would have amounted to an additional or surtax upon the corporation and would have done violence to this principle. This fact was evidently recognized by Congress as well as by the British Parliament in the imposition of the excess profits tax, for in each case the tax was imposed not only upon the corporation but upon partnerships and individuals as well in the hope of making an equitable distribution of the burden among all individuals as a tax upon business regardless of the character of the owner of the business.

It is extremely difficult to get an equitable distribution of an excess profits tax owing to the different methods of transacting business. It is probable that this system of taxation would not constitute a part of any well regulated tax system in times of peace. It is because in times of war certain businesses are extremely prosperous that it is thought equitable to take by taxation a part of the profits resulting from the war and use them for the purpose of conducting the war. This was the theory of the European excess profits tax acts and was the theory of our war revenue bill in the form reported to the Senate by the Senate Finance Committee. As the bill was finally passed, however, it became not a tax upon war excess profits unless the pre-war profits happened to equal from 7 to 9 per cent of the invested capital for the taxable year, but a tax upon profits exceeding a certain arbitrary percentage of capital.

As to all corporations whose pre-war profits did not fall within the special class, the tax under our War Revenue Act is not a war profits tax but an excess profits tax without regard to pre-war earnings. Therefore our tax upon excess profits at a sliding scale rate of 20 per cent to 60 per cent is not at all comparable with the war excess profits tax of Great Britain at the flat rate of 80 per cent. It might very well happen in a number of cases that our tax at a progressive rate of 20 per cent to 60 per cent would be much more burdensome to business in this country than the English tax upon war profits only, at the flat rate of 80 per cent, because in England only

abnormal profits resulting from the war are taxed while under our war revenue bill it is quite possible that the tax in many cases is based upon normal profits which bear no relation to the war. In England it was ascertained that the three years immediately preceding the European War were prosperous years for English concerns. These concerns were guaranteed a continuation of this prosperity free from the war excess profits tax by being permitted to select the two most prosperous years of these three prosperous years as a pre-war basis and all profits over and above the average profits of these two most prosperous years were taxed at a high rate but with full knowledge to the investing public that the normal profits of prosperous years would be guaranteed free from such tax.

It is of course less disturbing to business if the government can secure its revenue by a tax upon abnormal profits guaranteeing to the investing public a normal profit free from tax, than it is to place such tax upon normal profits and in the absence of such guarantee. As stated at the outset the object of any taxation scheme should be to produce the maximum of revenue with the minimum of disturbance to the business taxed.

Our revenue act on the other hand does not guarantee any freedom from taxation of all pre-war earnings, because as we have seen in a number of cases, our excess profits tax may fall upon normal profits or profits which have not increased or which perhaps have decreased since the war began. Our revenue act is not based upon war profits but may more properly be said to be based upon ability to pay upon the part of the business taxed, Congress having assumed arbitrarily that any earnings over and above a certain arbitrary percentage of the invested capital represent ability to pay taxes, to the extent of the exigencies of the government. It is probable that if each business could be treated separately, it could be ascertained in the case of each particular business what would constitute a reasonable exemption for the particular business. It is probably equally true that if each business, regardless of its nature or hazards, is permitted the same rate of deduction based upon the capital invested the scheme will necessarily bring about inequalities, taxing some businesses upon earnings abnormal and some upon earnings that are only normal or possibly less than normal.

It would seem that if it be found advisable to impose an excess profits tax instead of a war excess profits tax, that is, a tax based

upon earnings in excess of a certain arbitrary amount instead of a tax upon earnings resulting from the war and in excess of normal earnings of the business in each case, then some reasonable attempt should be made to classify business in regard to the hazards of the business so as to determine what the deduction should be in regard to each class of business taxed. An arbitrary deduction of 9 per cent on the capital invested, for example, is probably insufficient to guarantee to certain classes of business a fair return upon the capital invested free from the tax while it is probably more than sufficient for such guarantee in the case of other classes of business.

In the imposition of the capital stock tax the United States Treasury Department has officially determined that a certain class of corporations geographically located in a certain way must earn a certain amount on the capital invested in order to make the stock worth par, while other classes of corporations, or the same class differently located geographically, must earn an altogether different amount to make the stock worth par. This fact established by the United States Treasury Department is a confirmation of my contention that you cannot set up an arbitrary allowance of percentage upon capital invested and apply it generally to all business without favoring certain classes of business as compared with other classes.

In closing I want again to say that the object of any tax legislation should be the maximum amount of revenue with the minimum of disturbance to the business taxed. A tax upon an individual, as such, apart from his business, who ultimately receives all business profits, can probably be borne with patriotism without disturbance to business enterprise, but a tax upon business whose credit depends not upon patriotism or anything emotional but upon sound business finance, if sufficient to interfere with such credit, may upset the whole financial and commercial structure of the country, and the result of such business disturbance is much worse in times of war than in times of peace and probably produces more suffering among the people as a class than any tax ever laid upon an individual as a personal tax.

WAR AND FINANCE IN RUSSIA

By His Excellency, the Russian Ambassador,
Hon. Boris Bakhmeteff.

Finance is unquestionably the most essential element in the material end of any warfare, and this occasion gives me the best opportunity to emphasize again the splendid help which this great country is giving at present to the Allies by financing their purchases. Experience has shown that the expenditures of war have increased year by year, the different nations being obliged to keep pace in their financial plans with the requirements, and gradually adapting their policies to the development of demand. The United States entered the war when the military operations in Europe had reached their full swing and when on the other hand financial resources had been greatly exhausted. This government, therefore, has had no opportunity for steady and gradual development of financial methods. At the outset this country had to face the necessity of organizing its national military mechanism on a scale adequate to present European practices. In addition, the general conjuncture imposed the necessity of undertaking the most extensive financing of all allied countries.

The United States was thus obliged to face from the very beginning an annual war budget of over twenty billion dollars, thus in the first year equalling the whole of the expenditure of any European country since the beginning of the war. A financial problem was thus set before the government and the people of this republic, which both in magnitude and spontaneity has probably never had a precedent in the history of state finance.

The solution of this problem depends not only on the ability and mastering of statemanship, but relies to the greatest extent on the willingness of the people to contribute to the success of the governmental undertaking. It is in the patriotism and in the readiness to carry the burden of increased taxation, to moderate individual consummation, and to respond with all possible means to the appeal of the government to support loans, that there lies the possibility of success. It is the united effort of democratic action that is de-

manded by democracy at war. It is the sacrifice of the people of the United States to the great cause of justice. I feel that I should avail myself of this opportunity to pay a small tribute to the patriotic exhibition of the people so manifestly exemplified in the success of the liberty loan.

Russia entered the war in August, 1914, at a period of economic prosperity which followed an epoch of financial and economic depression, caused by the Japanese War and the subsequent revolution of 1905. War and political troubles had shaken the welfare of the country by imposing heavy indebtedness and by disorganizing normal activities, but the resources of the country were so rich and their development so successful that in the seven years (1907–1914) Russia had fully recovered. Still more, it had reached an unprecedented state of welfare.

The Japanese War had cost Russia about three billion roubles. This new indebtedness had not only been fully "digested" by the country but it was possible to raise the state budget from about 2.4 billion roubles in 1908 to 3.4 in 1913 and it should be remembered that this immense increase was used greatly for cultural purposes and did not necessitate new loans. In fact for several years before the present war the budget had not only been balanced without deficit, but the Treasury was able to accumulate from the surplus an emergency reserve fund of about five hundred million roubles and in addition to diminish the indebtedness by paying off about two hundred million, thus lowering the total state debt from 9.05 billion roubles in 1910 to 8.85 billion roubles in 1913. A vast gold deposit accumulated in the Treasury. On January 1, 1914, there were one billion, seven hundred million roubles of gold in the vaults of the state bank, the total metal reserves including foreign liabilities surpassing two billion. The Russian gold reserve was thus the largest in Europe, the British being in 1915 about eight hundred million and the French one and one-half billion roubles.

However prosperous were the general conditions of the country it is clear that all the normal sources of revenue were inadequate to meet the requirements imposed on the Treasury by warfare,—and this, although the war in the first year did not actually require excessive disbursements. It is most interesting to follow the increase of the cost of the war in Russia. During 1914 the expenses were only about twelve million roubles a day. They reached about

twenty millions in 1915, increasing from thirty-five to fifty million in 1916. At present Russia is spending about fifty-five to sixty million roubles a day.

The low expenses of the first year of the war are to be explained by the fact that during this period the army was using war material previously accumulated, and forming the regular complement provisioned in the mobilization plans. On the other hand, due to the richness of Russia in victuals, there had been at that time no substantial rise in prices. Deficiency in food supply was felt only late in the second year of the war. It was one of the greatest mistakes of the old government not to have introduced food regulation at the very beginning of the military operations. How fortunate for this country to have adopted a policy of sane regulation at the very beginning of warfare. The expenses of war increased in measure later as new extensive orders had to be placed to cover deficiencies in ammunition and as there had to be met the increased cost of food, raw material and labor.

To cover the expenditures of war extraordinary financial measures have to be adopted. Of such there are three: (1) increased taxation; (2) loans; and (3) emission of bank notes. All of these three methods were used in Russia from the very beginning of the war.

Taxation. It should be remembered that at the very beginning of military operations regulations for complete prohibition were issued and the sale of alcohol and vodka suspended. This fact had the most beneficial result for the general welfare of the country and was of the greatest political and social consequence. But at the same time it caused a decided "gap" in the budget causing a loss of about one billion roubles.

Characteristic of the situation in Russia all throughout the war had been the fact that all increases in taxation had been only about sufficient to cover the expenditures of the civic budget. At the start it was necessary to cover the deficit due to the suspension of the sale of vodka. Later, one had to keep pace with the increasing expenditures, and this notwithstanding the fact that the progress of taxation had been very substantial. All taxes were practically raised: direct, indirect, excises and duties as well as the revenues from state monopolies. In some cases taxes were nearly doubled. Railway fares and postage were increased 25 per cent. New taxes

were imposed—an income tax, a tax on war super-profits, etc. Comparing the budgets of 1914 and 1917 we find that 566 million roubles were obtained by direct taxation in 1917 as compared with 206 million in 1914, the total levy of taxation amounting to 2.1 billion in 1917, as compared with 1.24 billion in 1914. In order to appreciate this additional tax burden one should take into account the loss of territory and the extensive reduction in the number of taxpayers, due to casualties amounting to many millions of men during the bloody first period of the war. Further taxes have been imposed since the revolution, principally in the line of direct taxation, and the civic budget increased to about 5.4 billion roubles, which, taking into account the elimination of the vodka revenue, means an increase of more than 100 per cent on the budget of the pre-war period. I wish to mention at this time that the country met this increase in taxation with a readiness to sacrifice and contribute. The war was exceptionally popular and notwithstanding the hate which all people had for the old régime and its government, the growth of taxation was met without murmur and with calmness.

The revenue of 5.4 billion roubles is to be confronted with a provision of 4.8 billion, representing the expenses of the civic budget. Thus about six hundred million roubles are left for war expenditures. But this amount, however great from the point of view of a civic budget, is insignificant when compared with the annual requirements of warfare, which amounts at present to more than twenty billion a year. Other measures, therefore, to meet the necessities of warfare had to be applied.

Loans. Already during the first months of the war, an internal loan was issued for an amount of 500 million roubles. It is an interesting recollection to state the difficulties which the government had to face at that time when raising a loan, although of such a small total. It has been an experience of this war, so far as I know characteristic of all of the countries, that with the progress of the war the raising of loans was getting more and more easy and one can surely state that more difficulty was encountered in raising the first 500 million roubles in 1914 than in the issuance of bonds of greater totals in the later periods. In 1915, three loans amounting to two and one-half billion, and in 1916, two loans with a total of five billion were issued. After the revolution a new liberty loan was

launched which amounted to about four billion roubles. The total amount of loans exceeded eleven billion and in addition, short term certificates were issued of which four to five billion roubles were purchased by the people.

Internal loans were followed by foreign loans, especially since 1915, when extensive orders were placed in foreign countries. The war suspended Russian exports and deprived the country of an active trade balance which had been sustained for many years. From several hundred millions of active balance (surplus), the country in 1915 was brought to a passive balance (deficit) of more than seven hundred millions, and in 1916 to one and one-half billion. It was absolutely impossible to cover such extensive foreign purchases by loans issued freely on the market. Financing on such a scale could be operated only through government channels.

This fact of inter-allied government coöperation in financing is another characteristic feature of the war. In 1915 certain agreements were made for mutual use of financial facilities by Great Britain, France and Russia. These arrangements later resulted in formal agreements between the allied governments which provided Russia with certain monthly allowances in foreign exchange to cover expenditures of foreign purchases, conditioned, however, by certain modalities to the effect that purchasing of foreign goods would be centralized to avoid competition and that certain regulations should be provided for, so as to attain an efficient and practical form of commercial transaction. The total amount of foreign war loans until April, 1915 was about five billion roubles. Out of that only 320 millions, or about 6½ per cent, had been obtained through loans issued on a free market; of this amount one-half was loaned by the United States.

Summarizing, one sees that about sixteen billion roubles were procured during the war through long term internal and foreign loans and about four million from short term certificates. This amounted to about 60 or 70 per cent of the actual expenditures of the war.

It proved impossible to draw out more funds from the people and to return to the Treasury a higher percentage of the moneys expended within the country. This, to a great extent, was due to the fact that a considerable amount of money spent has been distributed within the peasant class, the small cultivator who is unac-

customed to investments and often prefers to hold his money in specie. The increase of the wealth and the rate of money holding within the country is most interesting. At least 80 per cent of the war expenditures have been made within the country; as a result the people during the war have become tremendously rich as compared with the pre-war period. The total deposits in all the credit institutions of Russia have increased from 5.3 billion roubles in July, 1914, to 12.5 billion in January, 1917; and to illustrate in particular the increase of wealth among the peasants, one should recall that the deposits in the savings banks have more than doubled. Yet, as I have said, it was impossible to raise all the money necessary by credit operations, and the government was compelled to issue bank notes. This measure, however undesirable, is in most cases necessary in the process of warfare. All countries have to use this resource. Great Britain, probably, has used it least of all, France stands in between and Russia has used emission to the greatest measure.

Issue of Bank Notes. Before the war the Russian currency was excessively stable. As I have told you, the gold deposits of the state bank, the only emission institution in Russia, were about 1.7 billion roubles. The emission laws permitted an issuance of paper money to an extent of only three hundred million roubles above the gold deposit. In fact, under existing requirements of circulation, the emission law had never been fully used; the amount of bank notes being a little above 1.8 billion roubles, thus being guaranteed by the gold reserve to about 90 per cent of their par value.

Since the beginning of the war the emission law had to be changed and further issuance of bank notes was permitted. These issues were made by the state bank against short term certificates of the Treasury, the state bank formally purchasing the bonds of the Treasury. In reality, this operation represents an emission with a reduced gold reserve and of course resulted in an inflation with paper money and in a depreciation of the value of the rouble. The total amount of paper roubles issued until the beginning of this year exceeded eight billion, thus lowering the gold guarantee to a great extent. The inflation of the country with paper money created a great depreciation of the purchasing power of the monetary unit, such depreciation being greatly increased by the fact of an acute shortage of commodities.

This lack of commodities is perhaps the outstanding feature of the present economic crisis in Russia. The suspension of imports and the militarization of industry, turning all the productive capacity toward munition work and thus reducing the production of commodities, had deprived the market of every-day necessities. Boots, clothing, household articles, metals and all kinds of elementary and necessary articles were becoming scarcer and scarcer, and this resulted not only in an outrageous increase of prices, but offered as well the basis for social ferment.

When Kerensky spoke recently of the sacrifices which Russia is now enduring, he certainly had in view all the difficulties of life encountered at present due to lack of food, every-day commodities, transportation, etc., which in the long run result in deprivation and suffering. The inflation of the currency with paper money brought as a natural result an instability of the exchange rate of the rouble on the foreign markets. I would like to mention at this time, that the prevailing exchange rates on foreign markets throughout the war in no way correspond to the actual state of the economic and financial welfare of the country, but have been conditioned (especially lately) by political factors, or have been the result of the inappropriate financial policy of the old government.

In fact the exchange rate did not affect the actual purchase of foreign supplies, these being executed by the government using credits granted under inter-allied agreements. The exchange rate affected mostly private purchases, so far as these were not regulated and covered by moneys obtained though governmental loans. Unfortunately, one must admit that during the war the old government had not taken a strong policy of prohibiting unregulated imports, and thus encouraged all kinds of private financial arrangements between concerns in Russia and credit institutions abroad, particularly in America. These transactions in foreign exchange had the most depressing effect on the value of the rouble. It should be remembered that the lack of commodities allowed the importer to sell at exorbitant prices which would protect him against any possible loss in providing foreign exchange. Such were the reasons why transactions were accepted under preposterous conditions. The provisional government of the Russian Republic has fortunately suspended this policy and has adopted a strict and centralized regulation of imports, thus practically excluding the possibility of any

private exchange dealing, which under the present conditions would lose its attractiveness.

I have presented thus far a short outline of finance in Russia. The result seemingly does not appear cheerful. Due to the inflation of the currency with paper money, Russia is undergoing an acute financial crisis which is completed by disorganization in transportation, and a crisis in the production of commodities. While the total indebtedness of the country had reached about forty billion roubles in 1917, the debt will undoubtedly increase by next year to about sixty billions. With a shaken financial system, and a depreciated value of the rouble, such liabilities seem rather depressing and the conditions under which the present government has to carry the responsibilities of statemanship and conduct the great country in the path of its historical destiny seem rather discouraging. Nevertheless, I am not afraid to expose the situation openly and frankly, and this not only because I have faith in a policy of straightforwardness, but also because I face the situation with perfect calmness having the greatest confidence and hope. The financial difficulties, which Russia will have to meet, are similar to those which will have to be faced by all other countries, both allies and enemies.

The essential feature of the problem of the financial consequences of the war lies in the necessity of meeting a war expenditure incomparable to any normal civic budget. It is this financial burden, which is comparatively equal for all the great powers, which will determine the future financial policies of all countries. When compared to this main task it will be a factor of second importance, whether at the start a country faced a favorable situation caused by a sane and systematic policy of credit operations, or will have to contend with a shaken financial system due to inflation. However different may be the initial conditions, for a country as a whole, as a certain economic unit, the main problem will be to absorb and to heal, in the process of economic development, the incurred bruises of the expenses of war.

All possible methods of liquidating the consequences of warfare do result in raising the state revenue. Increased state revenue involves eventually an increase in the amount of taxation and this means that a greater part of the income of the nation, of the output of the national production, has to be turned to the state for disposal.

As it is impossible to extend the pressure of taxes above a certain reasonable amount as compared with the national income, the only way to solve the question is to amplify the national production as such. It is therefore in the development of national production, in the expansion of economic activities, in the growth of the national output, that there lies, in the long run, the solution of the financial problems imposed by the consequences of war.

When determining, therefore, how a country will be able to meet the future situation, consideration should be given, first of all, to the possibilities of economic development and to the prospects of an increase of national wealth. This is a process, and a process of considerable duration. It should be considered as such and any occasional occurrence or situation should not be overestimated. In the long run, in the process of liquidation, the conditions in any country can change, political, economic and social; it is the potential possibilities of a country which should be taken into account and from this point of view a country, feebly developed, has even a certain preference over a country "economically saturated," that is, a country in which the existing relations between natural resources, labor and general conditions of economic activities have reached a conjuncture of intensity to exceed which is not permitted by the general balance of world competition.

It is from this aspect that one should value the present financial situation in Russia. The latent riches in Russia are well known. A country of practically unlimited territory, bountiful in natural resources, with an abundance of labor provided by an industrial and clever population, the efficiency of which has been hampered only by a lack of education, a country of excessively low economic "saturation," it is ready for the most spontaneous and intensive development. I would compare Russia to a youthful organism, promptly healing the heaviest wounds of economic and political disorganization.

One should recall the experience of the short period between the two wars (1907–1914), when progress was brought into Russian life by the establishment of the Duma, the first national representative institution in Russia. Of course, there can be no comparison between the financial problems of 1907 and those of 1917, but one should remember that in 1907 Russia was the only European country which had to deal with the financial consequences of a war, and

I recall how unsurmountable seemed to be to the people of Russia the financial problems which the country had to meet.

To illustrate what has been performed during the last decade, I will take two or three examples: the annual production of pig iron from 1904 until 1914 increased in Russia from 180 to 283 million poods, thus giving an increase of 60 per cent. The production of coal had nearly doubled. As to cotton, only sixteen million poods were used in Russia in 1905, of which ten were imported and six produced within the country. In 1916 the country consumed twenty-eight million poods, of which only seven million were imported. The joint stock of the banks had reached 632 millions in 1916 as compared with 237 in 1910. But nothing can serve better to evaluate the economic development of a country and to show its recuperative abilities than the rate of increase of the state budget. I will compare for example the growth of the state budgets of France and of Russia for the last fifteen years. If we take 1897 and 1912, that is a period of fifteen years, we see that the state budget of France has grown from approximately 3.4 billion francs to 4.5 billion, that is about 30 per cent. During the same period the Russian budget increased from 1.4 billion to 3.0 billion roubles. That is an increase of 210 per cent.

Therein lie the healing capacities of my motherland. You Americans have gone through a period of economic and political depression, when your country seemed on the verge of ruin but afterward entered upon the greatest period of economic development ever witnessed in the history of the world. I mean the Civil War, with all its bank notes, the depreciation of the currency, the disorganization of regular economic activities, and the ensuing period of unsurpassed development which brought this great country to its present state of unlimited wealth and unbounded economic capacity.

Russia, freed of the tentacles of despotism, free from restrictive and prohibitive legislation; Russia, literate and illuminated, with complete opportunity given to individual enterprise, will be easily healed of all the wounds and sores of the present political upheaval and economic crisis and will settle in the firm forms of a democratic commonwealth with an unprecedented development of her economic resources. The experience of history, the knowledge of the character of the country and of the spirit of the people give me confidence and faith in the future.

THE FINANCIAL EFFORT OF FRANCE DURING THE WAR

By J. Frederic Bloch,

Inspector of the French Ministry of Finance, Financial Representative of the French Government in New York.

The financial effort of France during the war is, indeed, a mighty one. In order to properly understand it, it will be sufficient to observe the constant increase of the credits approved by Parliament since August 4, 1914.

The expenses authorized have reached:

1. For the last 5 months of 1914	$1,260,000,000
2. For 1915	4,400,000,000
3. For 1916	6,200,000,000
4. For 1917 (estimated approximately)	8,080,000,000
Total	$19,940,000,000

This is without counting the advances made by France to some of her allies aggregating over $1,100,000,000.

France has, until now, met these enormous charges almost exclusively from her own resources, for until the entrance of the United States into the war, she had borrowed in foreign countries only about $1,100,000,000 of which $400,000,000 was in the United States, this last amount being approximately compensated by the loans granted by France to her allies.

These figures have increased since America's entrance into the war, especially owing to the financial assistance which they have so liberally extended to us. We fully appreciate it. In a recent speech the French Minister of Finance insisted on the invaluable military and financial support which the United States had brought to our soldiers. And I know he was speaking on behalf of the whole French nation when he addressed to your illustrious President and to the whole American people, the tribute of our admiration.

The patriotism of the people and their well-known thrift has made it possible for France to place two great loans which have yielded 22,000,000,000 francs, and to find in a regular and con-

tinuous manner the funds necessary for the operations of its Treasury, by a daily issuance of bonds of the national defense. These bonds can be bought in every office in France authorized to receive government funds, particularly post-offices where they are sold over the counter. The bonds are sold in denominations as small as 100 francs ($20.00) in maturities of one year, six months, and three months. They are widely distributed, every one buying some thus making use of all available funds. It is estimated that the issuance of these bonds has given the French Treasury a constant source of revenue which has not been less than an average of 1,000,000,000 francs per month, and continues to be obtained without any shocks to the financial market and without having at any time brought about a crisis or a tightening of the money situation.

This monetary situation rests on the strength of the credit of the Bank of France. Organized in the beginning of the nineteenth century, this powerful central institution has, from its origin, maintained at all times the stability of our fiduciary circulations and of our credit. At the beginning of the war, the general mobilization had brought with it, for a time, complete suspension of the economic life of the country. The moratorium of commercial paper was declared. At that time the Bank of France found itself charged with 4,476,000,000 francs ($850,000,000) of paper thus suspended. At the end of 1916 that amount was reduced to 1,340,000,000 francs ($250,000,000), the commercial and financial activity having been practically resumed on a normal basis and this enormous debt liquidated.

We find also in the study of the monetary circulation in France a strong proof of the patriotism of the French people. At the beginning of the war an appeal was made to the population asking them to deposit with the Bank of France, to aid the national defense, the gold in their possession; in less than one year the French people brought 1,300,000,000 francs of gold and since then this flow of gold has not ceased to increase. It exceeds at present 2,000,000,000 of francs, and after three years of war, although the bank has had to export large quantities of gold for the purpose of covering purchases made in foreign countries, its gold reserve is more than 5,300,000,000 francs ($1,020,000,000), showing an increase over normal times of peace.

But the floating of big loans, the issuance of treasury bills, and a certain increase in the fiduciary circulation are but temporary means of meeting exceptional conditions. It is necessary ultimately to resort to taxation as the final means of obtaining the revenue required to cover the increased expenditures. France has made large appeals to taxation. However, conditions created by the state of war, the mobilization of the larger part of its male population and the invasion of the national territory have forced the government to use fiscal sources of revenue with a certain amount of care.

It must not be forgotten, in order to fully appreciate the financial effort of France, that she has called under the colors approximately 7,000,000 men representing the best part of its active and productive population, and that one month after the declaration of war the Germans were at the door of Paris. The victory of the Marne repelled the invader and made it possible to reconquer a part of the ground temporarily lost. But, even now several of the departments of the north, the richest, most populated and the strongest industrially are in the hands of the Germans, and in the reconquered zone, due to the wholesale destruction committed by the enemy and due also to military necessity, a large part of the land has been found unfit for agriculture or industry and it has been necessary to remove a part of the population. It is estimated, without any exaggeration, that the number of citizens whose activity is lost for the time being for France for all these reasons is at least 4,000,000.

Notwithstanding so many unfavorable circumstances and thanks to the energy of the measures adopted by the government and the spirit of sacrifice shown by the entire country, the amount of fiscal revenue of the state, which had very naturally diminished during the first months of war, has been maintained in 1915 at the sum of about $745,000,000; in 1916 it already reached the sum of $900,000,000 and it is estimated that it will not be under $1,045,000,000 for 1917.[1]

[1]Taxes and revenue other than direct taxes to June 30, 1917—$450,000,000, or for the year, about	$900,500,000
New direct taxes	96,500,000
War profit taxes	48,500,000
Total	$1,045,500,000

So today, while the energy of the country is bent towards national defense, and a part of the land—the principal source of wealth to our country—is not cultivated for lack of labor, the taxes collected in France represent (after deduction made of the men mobilized and the population of the invaded regions) a charge of about $36 per inhabitant. In 1916 the impost and revenues of the federal government of the United States represented a charge of only about $9 per inhabitant.

In order to maintain in time of war at such a high figure the amount levied by taxation, the government did not hesitate to increase certain taxes and to create new ones which have been accepted by the public without complaint.

WAR TAXES IN FRANCE

1. The general tax on incomes, which had been under discussion in Parliament for years and always adjourned, has been put into effect for the first time during the year 1916, and the rate has been increased rapidly to 10 per cent with the exception of certain reductions at the base; the country has accepted without protest this measure, the necessity of which has been made plain by the war.

Other new taxes created are:

2. The tax on war profits has been fixed at 50 per cent of the excess of profits realized since the war; the rate of taxation has been increased since September 30, 1916 to 60 per cent of the taxable profits over 500,000 francs ($96,000). It is proposed for the present to increase the taxes on this last class of profits to 80 per cent.

3. Exceptional war impost for every man not mobilized including a fixed tax of twelve francs and a surtax of 25 per cent added to the income tax.

4. International revenue taxes have been adopted in addition to the custom duty on certain objects which were previously subject only to import taxes, for example on coffee about $7.50 per 100 kilos, cocoa about $4.50, chocolate about $4.50, tea about $7.50, colonial and exotic products, pepper, cinnamon, vanilla, mineral waters, special drugs, etc. The theaters or moving pictures have been subjected to special taxes representing as much as ten cents a seat and as much as 25 per cent of entrance charges.

5. An entire class of contributions has been doubled, taxes on mines, carriages, horses, automobiles, billiards, clubs and hunts.

Articles of public consumption have not been spared and even those the production of which interests particularly a large part of the agricultural classes of France, as wine and cider, have been subjected to heavy surtaxes. For instance taxes on wine have been increased to fifty-five cents, on cider thirty-seven cents per hectolitre (about twenty-two gallons). The taxes on sugar have been raised from $6 to $7.50, on tobacco from $2 to $3 per kilo. Taxes on alcohol have been raised from $40 to $75 per hectolitre.

6. The postal rate for the interior of France has been raised from two to three cents. The postal, telegraph and telephone tariffs have been materially increased.

7. The special tax on the revenue of securities has been increased from 4 to 5 per cent and on foreign government bonds and various foreign securities from 5 to 6 per cent.

Notwithstanding all these increased charges, the government feels that the country is ready to accept further sacrifices and in the budget for 1918 the Minister of Finance contemplated the adoption of new taxes, particularly on transportation, inheritances and commercial transactions which will probably represent an additional revenue of $230,000,000.

It is necessary to note before concluding that the fiscal system of France is very complex, and that it is very difficult at first sight to find what percentage of their revenue the French people pay to the state. The rate is certainly very high. For instance, the holders of bonds pay a large special tax (stamp, transfer, 5 per cent impost) which amounts, for the securities most widely held by the public (railroad bonds, real estate bonds, etc.), to about 15 per cent of the income, and if you add to this amount the new general income tax, you reach a total of 25 per cent. To this amount it is necessary to add indirect taxes, customs and state monopoly which enter for 78 per cent of the total of government receipts. Lastly, local taxes (department and counties) are also very heavy and in certain regions exceed the amount of direct taxes collected by the state.

It is not to be wondered that our population, many of whom have been so cruelly affected by the war, have been able to withstand under present circumstances such heavy fiscal charges, for it must not be forgotten that the wealth saved and accumulated for

so many years by the agricultural classes and the tireless spirit of thrift of the people are strong guarantees of the financial resistance of France. Also, the industrial development which, even in the midst of the war, is covering with factories regions, until now, bare of industry, gives us every confidence in the economic development of our country and in its ability to increase its financial contribution, which will have to be done in the near future.

For the task is not yet completed. The enormous war machine that has been set into motion for the most just and righteous cause, for the defense of what is dearer to us than our riches and our lives—our honor and our freedom—this machine must not stop, it will not stop until our aims are obtained, until victory and peace are ours. It will need more efforts and more sacrifices, in men and in money. We are ready to make them.

Recently, the French Minister of Finance announced that a third war loan of ten billion francs would be issued soon, and that new taxation would be necessary to meet accrued charges. We do not know yet what the exact conditions of the loan will be, we do not know exactly what are the new taxes that we will have to pay. But we know that the loan will be oversubscribed, that the taxes will be willingly and gladly paid.

I am saying this because it must be known that the whole French nation is ready to do its duty, economically and financially, while its sons are fighting on the battlefields. I am not saying it to teach the American people an example or a lesson. America needs no examples, no lessons. You have already given the proof that your patriotism and your generosity know no limit and that no difficulty could deter you in the course that you have freely determined to pursue—the great success of the liberty loan has won the admiration of all. It is the result of the most powerful and efficient financial organization, built in a few weeks by the genius of American financiers, bankers, merchants, and backed by the patriotism of the whole American nation. And even this is but a beginning and the rest will follow. We all know that our countries will continue, on the financial as well as on the military field, to fight shoulder by shoulder and to work hand in hand to obtain and to preserve for the whole world justice and liberty.

THINKING IN TERMS OF MONEY THE CAUSE OF MANY FINANCIAL FALLACIES

By Basil P. Blackett, C.B.,

Of the British Treasury.

I took a solitary walk last Sunday in Rock Creek Park, and as I walked I began to ponder on what I had to say in this paper. The sun was warm and after a while I sat down by the bubbling stream on a rustic bench, when suddenly I saw approaching me one of the famous bankers who have taken service at the Treasury during the war. The fact that he was on foot has made me wonder since whether it was a dream. Fortunately I refrained from hailing him, for just then there appeared from the opposite direction a figure which I knew somehow to be King Solomon. He was not gorgeously arrayed and was evidently war-saving, but there was no mistaking the regal presence and the intellectual brow. My friend the banker—for some queer reason my memory fails now to identify him with any particular one of the several eminent bankers at the Treasury, so that in a way he seems to be an embodiment of them all—recognized King Solomon at once and called joyfully to him:

"My dear King: This is indeed a pleasure, you're just the man I wanted to see. The perplexities of war finance and the problems which confront the United States Treasury are gigantic. We're asked to find $20,000,000,000 or more in a year, and we must borrow some $12,000,000,000 to $15,000,000,000 in the next eight or nine months. I simply don't know how the money is to be raised. You were dead right, King, when you said that money is the root of all evil."

"Good friend," replied King Solomon, "you know more of banking than of Scripture, or you would know I never said that. I may indeed have said that matrimony is the root of all evil. It was in my own case, and I fancy that my mother's first husband, the Hittite, must have felt the same. But let me suggest to you a new version of the proverb you misquote. It is this: 'Thinking in terms of money is the root of most of your evils.' I think you agree."

"Solomon is always right," replied the banker with a bow. "Undoubtedly our problem is not merely, or even mainly to raise the money. What we want for carrying on our part in this great war for democracy against Tyranny. . . . ."

"Pray do not consider my feelings," Solomon interrupted, "I'm a strong supporter of democratic principles now. They might not have worked in Jerusalem when I was there, but one of my reasons for meeting you today was that I hope that this war may be the means of bringing the blessings of liberty and justice to my poor old Jerusalem."

"No offense meant," said the banker. "What I was saying was that when we say we are asked to spend $20,000,000,000 in the first year of the war, we really mean that we have to secure for the use of the United States government for war purposes, labor, materials, food, commodities and services such as those rendered by soldiers and sailors and by non-combatants too, in all sorts of ways; we have to secure goods and services (to use a convenient short phrase) which, valued in terms of dollars, represent $20,000,000,000. The real problem is not so much to find the money as to find a surplus of goods and services to that amount available for the purposes of the government, over and above the goods and services which the 100,000,000 people of the United States are employing for their own private purposes. That's what you mean by your phrase about thinking in terms of money, isn't it?"

"You take my meaning exactly. And what I suggest to you as the only possible solution of your financial problems is that you should make the people of the country understand the state of the case. None of them understands what twenty billions of dollars means. You yourself probably don't go much beyond visualizing it as the figure twenty with the dollar sign before and followed by a comma and nine ciphers neatly divided by commas into sets of three. Meanwhile there's one of your friends in Wall Street who owns common stock in half a dozen sound American concerns, valued six months ago at market prices at say $1,000,000 and now valued at $700,000, who thinks he is ruined, and says the government has ruined him, and never stops to reflect that the stock in question represents a share in certain real things such as buildings, machinery and raw materials, which are probably not less valuable, and possibly more valuable (in terms of money at any rate) than they

were six months ago. And what's worse, some of your banker friends who ought to know better seem to think in the same slipshod way. Others cry that the great thing to do is to keep money circulating because it is good for trade—"business as usual." Other people cry out for conscription of wealth as a solution of all troubles, as if a house in Fifth Avenue or a bank in Chicago could be put on wheels and sent to France for use as a tank; or the Pennsylvania Railway Company's tracks could be torn up bodily and transported to Russia without anyone but the supposed millionaires who own them being any the worse."

"If you believe in democracy you are at any rate not a Socialist, I am glad to see," said the banker.

"Don't you be too sure, my friend," rejoined the King. "It depends on definition. But to continue, the thing to do is to get the people of this country to understand that money is merely a symbol, recognized by civilized people for their own convenience, as giving the owner of it for the time being a call on other people, the power of getting other people to work for him, the power to command goods and services which other people are able and willing to supply in order that by receiving a reward in money they may themselves have command of what they need for their daily sustenance and to keep a roof over their heads; or over what they desire to obtain for the sake of comfort and luxury. It is quite easy—as some of your friends the Socialists will gladly explain—to construct a theoretical state of society in which money would be abolished."

"No doubt it is," broke in the banker, "but would it work?"

"I did not express any opinion," was the reply. "But does not the fact that it is theoretically possible to dispense with money prove that money is merely a mechanical devise and nothing more, devised to keep a machine of a particular construction in easy working order?"

At this point King Solomon took a watch from his pocket and remarked that he could still spare a little time longer before starting off to advise the King of the Arabians on military matters. He suggested that they could continue their talk more comfortably seated, and I was a little alarmed when they made for my bench, which was not meant for more than two. Needlessly, as it proved; for in spite of King Solomon's ample proportions the small seat accommodated them both without my being so much as observed.

"King," resumed the banker, "that's a fine watch of yours, but I notice you wear only a common cord as a chain."

"The watch is an heirloom," Solomon answered. "It belonged to the Queen of Sheba's grandfather, and I could not get a tithe of its value if I sold it. But my heavy gold chain went more than a year ago to swell the gold at the Bank of France, and I gave the proceeds to relieve the Armenian sufferers."

The banker looked as if he would like to pay a tribute to this generosity, but stopped short; no doubt from a sense of reverence. Instead, he resumed the discussion with the words: "You do not, of course, suggest that we could or should supersede money in arranging the finance of the war?"

"Certainly not," was the reply. "But keep money and finance in their proper place as useful bits of machinery, and meanwhile go out to the people and explain the facts."

"That is a big undertaking," said Mr. Banker. "Do you think it is really worth while?"

"Surely, surely," said Solomon. "If you want to accomplish what you have set out to do that is the only possible method in this country. In Germany there has been no need to explain. The people have been dragooned into saving, if only by the British blockade which has forced the whole population to organize itself on a war basis. There, everyone has to serve in such a way as the Junkers think most likely to help them in conducting the war, producing all he or she can, and consuming only what is absolutely essential to keep body and soul together, and sometimes less. In France and Italy, and to some extent in Great Britain, similar necessity has been at work, and this has been reinforced on one side by continual lessons and appeals for patriotic self-denial, and on the other by drastic legislation prohibiting the import and manufacture of anything that could be done without. Nearly everyone in these countries has realized this truth. Do you not remember the Song of the Pennies, which the children sing in England?

> With five pounds the cost of a rifle
> Why, what can a poor penny do?

And then the chorus, in which Sergeant Shilling joins:

> We are each small enough, it is true;
> There's little a penny can do;
> But a cartridge to fire from a rifle
> Is just what a penny can do!

All over the world the children learn this truth at once. Last Christmas Mr. Lloyd George received a letter from Arizona which said: "Please sir, Peggy is eight and baby is five, and I am ten, and we should like these five dollars to be used to give some of the poor suffering people in England a happy Christmas." There was a further note from their mother: "This is entirely their own idea. Their uncle gave them a dollar each to buy themselves Christmas presents, and they have saved the other two." And next to the children the working girls have been the quickest to learn. The mill worker of Milan, the midinette of Paris, the munition worker in London have been among the first to see how they can help. Each of them has worked harder and earned money, not to spend on herself, but to lend to her country, so that the government may have the wherewithal to buy cartridges and hand-grenades to protect the lives of their boys at the front. Many of them have understood well enough that the money they lent to the nation came back to them as wages to pay for the cartridges they were making, and that by not spending it on themselves they were setting labor and materials free to be used to help on the war. Do you remember the poster advertising the British War Savings Certificates? "One hundred and twenty-four cartridges for 15s. 6d, and your money back with compound interest!"

"Yes," said the banker, "I've seen specimens of that poster, and it certainly concentrates the appeal for savings into a very compact and alluring sentence. We're thinking of issuing something on the lines of those British War Savings Certificates here."

"An admirable plan" was Solomon's comment. "I congratulate you. These hectic liberty loan campaigns, whirlwind weeks during which every art is employed to make everyone eat and drink and work and play and dream to the tune of 'Buy a Bond' are wonderful events, and by the way I must congratulate the Treasury through you on its remarkable achievements this last month. But these campaigns have their disadvantages."

"That's so," said my friend the banker, with conviction. "They use one up terribly and they upset the market a good deal."

"I was not thinking so much of that," answered King Solomon. "You mention some of the objections, but the main disadvantages, to my mind, are that they encourage people to think in terms of money, and as soon as the campaign is over people settle

down to their old habits of extravagance. What I like about the War Savings Certificate is that the campaign goes on continuously and involves something deeper than a passing emotion. People get the habit of daily saving and the incentive to go on saving, because there is always a form of war loan which they can buy, and there is no temptation to borrow money to subscribe, and then forgetfulness to save to pay off what was borrowed. But my time is nearly up. Let me tell you a story before I go. You remember the victory loan campaign in Great Britain last January and February, when $5,000,000,000 of new money was raised (after two and one-half years of war) quite apart from the fact that some $1,500,000,000 to $2,000,000,000 of three- to five-year bonds were converted into long-term loans. (I must begin by apologizing for the misuse of language in this story. It arises from a habit I have of accurately reproducing conversations.) One evening Robinson, a war loan worker, was sitting in his club after a hard day's work, when an acquaintance of his, Smith, came up and introduced a third man, Jones. Robinson knew Smith to be on the stock exchange and gathered that Jones was also a member. He knew nothing of their monetary position. The talk soon turned to the war loan and Smith remarked that he had not made up his mind yet what he would do. He had, he said, taken £10,000 of the four and one-half per cent war loan in July, 1915, and been badly stung—a slang term which implies that his investment had not been wholly satisfactory. So I judge from Robinson's rejoinder, that a man who had invested in that loan had no need to complain, as he could now convert it into the new loan on very satisfactory terms. 'Yes, I know,' said Smith, 'but I got so sick with the way the bally thing fell, and the idiotic government did nothing to help, that I sold it and bought some American rails, and now the robbers are commandeering these; and I've two sons at the front, too. There's no gratitude in these confounded politicians.' By this time Robinson was fairly roused and he proceeded in half an hour's patient exposition and exhortation to give a masterly display in securing a difficult subscriber. In the end Smith seemed deeply impressed. 'I never saw it in that light,' he concluded, 'and I'm hanged if I won't take £50,000. I'll have to borrow the lot at my bankers', and I've an overdraft already, but from what you say I think I can square them.'

"All this time Jones had said little, though he had seemed to be listening attentively. Flushed with his success with Smith, Robinson now turned to Jones. But he could get nothing more out of him than that he had considered all the means available to him and had reluctantly decided that he could not subscribe.

"Six months later in the same club Smith and Robinson met again. 'You made a fine fool of me that night,' said Smith. 'Just let me tell you what a mess you got me into. I've had the most ghastly day of my life today. I was offered a half share in a partnership to develop a new ruby mine 'somewhere in Asia.' It's the chance of a lifetime. Only £100,000 wanted. We can't float a company till after the war because this sickening government won't let anyone issue new capital unless it chooses in its wisdom to say the issue will help to win the war. Well, I said I was on, and I went over to my bankers to arrange things when the manager said he was sorry but he couldn't increase my overdraft, and had the cheek to suggest that I ought by now to have paid off some of what they lent me to take up your blessed loan. He wouldn't lend me money on any of my other securities without being told what I wanted it for, and when I told him he said that the bank could not advance money which was to go abroad, or for a purpose which was so obviously not necessary for winning the war. And then, not content with these insults, he proceeded to suggest that people with much smaller means than mine had succeeded in paying off very big sums borrowed for subscribing to the loan, and would I please consider the matter seriously. I was so angry that I told him to sell the bally war loan for what it would fetch and be done with it. He didn't like it, he said, but if I was really determined to forget that we were at war it was probably the best thing I could do.

"By this time I was so infuriated that I said I would close my account and find a bank where the managers were gentlemen, or at least taught to behave like gentlemen. I went straight across to my friend Brown—you know the bank. Well, I'm hanged if Brown didn't tell me that he thought my bank had been remarkably patient—that in any case he could not help me, as the London banks had agreed not to take customers from one another if the reason for the change of bankers was that a customer had failed to get accommodation for a purpose which was obviously not useful to

the war. So here I am absolutely dished. I've had to say I can't go half shares in this show, with the result that the whole thing's off. I've quarrelled badly with my bankers, and altogether I'm in a fix. Coal's a staggering price and I've just added two new palm houses to the glass I have to keep going. I've two sons in the army, and I might at least claim that amount of luxury. Incidentally I've only managed to keep my head gardener, who thinks he ought to enlist, by threatening to turn his wife out of his cottage if he does. He's forty-five and has two sons at the front and ought to be ashamed of himself; and with the wages I'm paying him he's a regular millionaire. Why he told me he'd got over sixty War Savings Certificates now. Well! you deserved this tirade, you know, as you're the scoundrel at the bottom of it all. I must be off now, as my son's coming up from Aldershot, and we're going to paint the town red to drown our troubles. So long.'

"Scarcely had Smith gone, when Robinson saw Jones approaching. He tried not to be seen as he thought that he couldn't bear to talk with another of his failures that day. But Jones made his way quickly to him. 'Hullo, Robinson,' he began. 'I suppose you're not particularly anxious to renew my acquaintance after the way I met your war loan appeal. The fact is you made me feel thoroughly mean that night but I couldn't help myself. I've something better to tell you today, and that's why I've ventured to speak to you. I'd have liked to do it before but I didn't have the courage. The fact is I used to have a pretty good business in the American department of the stock exchange, but that's gone altogether because of what the government—quite rightly, of course —had to do about American securities. Then just when I was hoping to get our house let so that we could move into a cheaper one, our two boys got killed on July 1, 1916, the first day of the Battle of the Somme. The shock was too much for Mrs. Jones and she had a complete nervous breakdown, and we had to have two nurses in the house and no end of expense for special treatment and specialists—though I must say my doctor has been a brick about his own account. The result was that last February I had got rid of practically all my capital except the 4½ per cent war loan I'd bought, and I had an overdraft of nearly £600 at the bank. I was earning something at the Ministry of Munitions where I had got a really useful job. But I had refused to take anything much by way of

salary when I had enough without and I didn't think it fair to make the country pay because of my new troubles. Thank goodness things are quite easy now. My wife's recovered. We've shut up all but two rooms in our house, and my wife's as happy as can be in saving for the sake of the other mother's sons. She's a great woman, though I say it that shouldn't. And you've no idea how jolly it is. The wife got places for two of the maids at the munitions factory near us and sometimes they drop in to tea with us on Saturdays and tell us about their work and talk of what they'll do when the war's over. Did I tell you that the wife's promised to have them back? And the kitchen maid's working as conductor with the omnibus company, and she and I have a chat sometimes when I happen to come down to work on her 'bus. Well, the result of it all is that I've paid off the bank overdraft and they've lent me enough to buy £500 of your war loan in the market, and that's partly paid off, and all of us, Mrs. Jones and our old servants and I, are members of a War Savings Association in our neighborhood and we're piling up War Savings Certificates. So I feel that I can look you in the face again. . . . Eh well, so long! It's good of you to say such nice things of our small efforts, but we're really trying to help, you know.'

"Robinson's effort to restrain Jones from flying from his praises proving vain, he sat for awhile and pondered on the two cases.

"But I need not tell you his conclusions.[1] I'm afraid my story's rather long already," said Solomon. "And now I fear I must hurry

[1] As neither King Solomon nor the banker explained the conclusions to be drawn from the two cases, I do so, though with diffidence. I suppose they would be something like the following:

Smith had at best merely put his own and his banker's credit at the disposal of the government on false pretences for a few months during which someone else (such as Jones) had been able to build up new savings with which to replace the gap left when Smith sold his loan. More probably he had compelled the government to find £50,000 in June to wipe out (by means of the special war loan depreciation fund) the fictitious credit based as it proved on no real goods and services, which Smith in a moment of shallow emotion had allowed the government to build upon.

On the other hand, Jones in six months had:

1. Saved £600 to repay his bank, thereby
2. Setting goods and services to that amount free for the government
3. Undertaken to save a further £500 and already saved part of it

off or I shall be late in Arabia. The connections are not good, I find, in these days though I'm glad to say that Beersheba Junction is open again. Goody-bye, my friend."

And with that he vanished, and the banker somehow disappeared too. But I noticed that a fly leaf had dropped from King Solomon's pocketbook, and when I picked it up I found it covered with all sorts of odd sentences in a minute handwriting, of which I quote a few:

"He that gathereth not scattereth abroad."

"Every dollar saved helps twice, first when it is saved and again when it is lent to the nation."

"Millions in the belligerent lands have for the first time an opportunity of laying by a little capital. It is the chance of generations. Will they not take it? They help their country and themselves by saving."

"If man would but learn the duty of right spending, he would learn the greatest pleasure in the world."

There were other sentences also which I did not decipher. But I particularly noticed that on each side of the fly leaf there was printed in red letters a sentence which evidently appeared in a similar place on each leaf of the note book from which it came, and the sentence was this:

"Where there is no Vision the People perisheth."

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4. Lent the £500 to the government for war purposes on the security of his intention to save, backed by the bank's credit, thereby
5. Giving the government command over goods and services to the full extent to which the self-denial of the Jones family was setting goods and services free, and
6. Had evidently been exercizing an untold influence for good in aiding others to find fit places in a nation organized for war.

B. P. B.

THE FINANCIAL PROBLEMS OF ITALY

By F. Quattrone,

General Secretary, High Commissioner of Italy.

In America's social organization, which is based upon individual liberty and in which every economic enterprise has had capital as its basis, all energy, all means of production have always been concentrated in the most appropriate way, and the entire available capital has always been employed in the most intensive manner.

The country's very large production and the wide extent of its trade have produced enormous wealth. Thus, when the supreme moment of decision arrived, this wealth converged towards the realization of great democratic and humanitarian ideals, which are the basis of President Wilson's policy, and other currents of capital flowed towards the success of your liberty loans, in order that your government might be placed in a position to take a powerful part in the solution of the financial problems of its European allies.

To accomplish this great and strenuous task which America has undertaken, there are required men who can face a superhuman work of preparation to overcome the greatest difficulties. Men of strong fiber, intelligence and endurance, able to give impulsive force to the new course that the finance of the United States has been called upon to take. America has had these men and it is now with respect and emotion that I mention the names of William G. McAdoo and Oscar T. Crosby. Only through the activity of these two men and that of all of their coadjutors, has the United States been able, up to the present time, to grant to the Allies a loan of $2,851,000,000, while the second liberty loan has also proved a great success.

What are the economic difficulties of the Allies? What are Italy's sufferings? What are we, ourselves, in this cataclysm which has turned the world into chaos? Let us have a broader vision of this war. What matters most is that civilization might be reconstructed, and that the world might be reorganized for the cause of liberty, justice and peace.

The Allies are concentrating all their efforts; Italy stands now in the first line ready to endure with incredible sacrifices of abnegation the most tremendous attack of the Austro-German forces. But notwithstanding these conditions, we feel sure that in the end, the unity of Europe will not be formed under the heel of the junker, and then America will realize the part played by her in the unity of all democratic Europe.

Let me say a few words about Italy. I shall confine myself to financial matters. The financial situation contains, often in itself, virtues, sacrifices and the destiny of a nation—and this is the true case with my country. At the outbreak of the war, in order to meet with the enormous requirements of her army and navy, Italy made appeal first of all to internal savings: four internal loans have been floated for the amount of four billions francs, and this the entire nation has answered unanimously. But loans are not sufficient to keep up the needs of a nation; they must be supplemented by a constant flow of other revenues. From this follows what we call "fiscal policy," or in other words "system of taxation."

In normal times, prior to the war, we had direct taxes on land and properties, income taxes, taxes on business transactions, on the manufacture of the most important and indispensable products (as sugar, oil, bicycles, motorcycles, automobiles, alcohol, beer, gas, electricity, etc.), customs house duties and maritime charges. We had a monopoly of tobacco, salt, postal facilities, telegraphs and telephones, and the government took over the management and control of the entire system of railways together with certain steamboat lines between the continent and the islands of Sardinia and Sicily. The collection of all these revenues wisely managed was sufficient to cover the enormous expenses sustained by the state.

How many other sacrifices have been undergone by capital, property and Italian labor on account of these high national aims?

I repeat that the financial situation of a people sometimes reveals great virtues: I can tell you that the payment of fiscal contributions in my country is a sentiment of duty as deep as religion.

When the war broke out the Italian government could not do otherwise than to take recourse again in its most secure sources of revenue. New sacrifices have been asked, much heavier demands have been made on the old revenues, increases in the prices of all monopolized articles have been applied, postal, telephone and tele-

graph rates also have been increased; railway facilities have been curtailed; while new government monopolies have been created, such as the manufacture of matches, playing cards, and recently the manufacture of shoes.

All of the existing taxes for the manufacture of the most indispensable and important articles have been raised again and war taxes have been imposed on theaters, moving pictures, automobiles, driving horses, carriages and servants. The whole amount so collected by the Italian government during the fiscal year 1916–1917 reached the figure of 3,207,226,394 lire against 1,854,023,147 lire collected during the fiscal year 1914–1915.

Notwithstanding these facts, our system of taxation had to attain a higher goal full of significance and results. It was necessary for my government to deal also with excess war profits and find in the industries created by the war a new source of revenue; in such way a limit has been put to the enrichment of those making big profits out of the war industries. A new tax has been imposed and consequently from 60 per cent to 80 per cent of the profits of the Italian manufacturers and merchants is passing from them into the Italian Treasury.

Later the extraordinary emergencies of the war have compelled us, as France and England, to avail ourselves of the loans of money granted by the United States.

My country, which has almost six million sons in the war, is the country of labor. Labor is the force which creates and augments national prosperity. Many of you who have travelled in Italy in times of peace were attracted by the beauty of the landscape, by the ruins of our ancient civilization, but perhaps did not have time or wish to examine the economic progress of Italy in the new century.

I do not wish to tire you with figures, but cannot refrain from mentioning some significant data showing our economic development. I shall not dwell upon metallurgic industries; which, for example, while in 1901 produced only 15,000 tons of pig iron and 123,000 tons of steel, in the year preceding the war had attained respectively 379,000 tons of pig iron and 800,000 tons of steel. I shall not emphasize the fertilizing industries, which from 900,000 tons produced in 1900 has attained a production of over one million tons in 1913.

Quite apart from the fact that in 1913 the mercantile marine also has doubled the tonnage of imports, and the export trade with the United States has been doubled in comparison with the year 1900, I wish only to remind you that Italy has a potentiality of four million horse power of hydrodynamic force, of which 24 per cent has been already utilized. I think that the following résumé, regarding the disposable amount of hydraulic power, in comparison with the percentage of utilization, can give you an idea of the progress attained already in my country and of what its industrial future will be:

HYDRAULIC POWER

	Disposable (1000 H. P.)	Utilized, per cent
Switzerland	2,000	25.5
United States	28,000	24.9
Italy	4,000	24.0
Canada	8,094	21.0
Norway	5,500	20.4
Sweden	4,500	15.6
France	5,587	11.6
Spain	5,000	8.8
England	963	8.3

In comparison with the territorial surface we have respectively the following which shows the amount of hydraulic power per square mile utilized:

	H. P. per square mile Disposable	Utilized
Switzerland	125.20	32.00
Italy	43.80	10.70
Norway	44.30	9.02
Spain	26.00	4.08
Sweden	26.00	4.08
France	27.00	3.14
United States	9.30	2.31
Canada	8.74	1.83
England	10.90	.91

The immense reserves of our Alpine blue waterfalls and those of the Appenines are gradually being utilized and the so-called white-coal will solve the most serious problem of my country: a long system of electric wire will be extended throughout the Italian peninsula, like so many arteries carrying life through the human body.

I said that labor is the force that creates and increases the prosperity of a nation. You may see at close range what a precious contribution of industrious and intelligent labor has been given in this prosperous country by the Italian immigrant, and you can follow also the progress of this large colony of ours. While the Italian emigration to the United States during the year 1880 was only 11,000 persons, in 1901 it reached 125,000 and in 1913 about 407,000. We in Italy say that the biggest Italian city is New York, where about 700,000 Italians are living.

In the meantime the Italian population increased from thirty-two millions in 1901 to thirty-seven millions at the present time. This increase means, for a country, an increase of its active forces, of its political power, an enlargement of its social, intellectual and political problems.

The six million men will return after the war to the farms, to the industries, to the profitable work coming after peace, and there my country, notwithstanding the temporary reverses suffered, will grow stronger and with its immense work will certainly give proof of having well deserved the confidence placed in her by American capital in the time of need.

May your country, inspired and with the full knowledge of the sacrifice of blood, money and property endured by all the allied powers, realize the necessity of coöperating with your government for the triumph of a universal and real democracy, based on the principle of liberty and justice.

BOOK DEPARTMENT

BUSINESS MAN'S LIBRARY

Banking, Investments and Finance

Anderson, B. M., Jr. *The Value of Money.* Pp. xxviii, 610. Price, $2.25. New York: The Macmillan Company, 1917.

Dr. Anderson has added a large book to the already voluminous literature relating to the value of money. His book is not only large, but also laborious, and much of it deals rather abstrusely with more or less familiar problems and conditions. These characteristics tend to make a subject, of itself difficult, unnecessarily repellent. There is a great deal of psychology, mathematics or mathematical notation, and historical "side light" in this volume. In addition there is a great deal of bibliography, and the student gets the impression that the machinery employed is more important than the conclusions. It is not inconsistent with the criticism just offered to say that the volume shows learning and wide reading, and that for those who are able to sift the material therein presented with some care, a perusal of the book may be of benefit. It might be an interesting book regardless of its conclusions, if the author had avoided the use of an academic dialect which obscures the meaning of many sentences to all except those who have accustomed themselves to the peculiar idiom which is used by some writers on value and money.

Beginning with a treatment of economic value in the abstract, the author then offers a discussion of the value of money as a special phase of value. This is continued in various applications through four chapters which, with the first, make up Part I. Part II is a discussion of the quantity theory of prices and money, and of credit as a factor affecting money values. Incidentally, the author has something to say of foreign and domestic trade, and the function of money and the precious metals therein. There is also some interesting discussion of stock exchange speculation. Part III discusses the value of money and the position of credit as factors in the modern economic organization, while Part IV, The Reconciliation of Statics and Dynamics, makes some special applications of economic theory to monetary and price questions. Probably the matter contained in Part III will be of largest interest to the practical or general reader, and it is likely that the impression produced by the book will be dependent largely upon the judgment to be formed by such readers concerning the validity of the views and conclusions there set forth.

In a broad way, the view of the author is hostile to the quantity theory of money, but he is apparently indisposed to accept any of the theories of money value now in existence. This would be no ground for complaint, if a new and more satisfactory theory were offered, but it is difficult indeed to ascertain the author's idea on the subject. How strangely the phases of the book which have to do with strictly practical questions have been distorted by his tendencies

toward abstract speculation, are seen in his "important practical conclusion" (page 578), that federal reserve banks ought to be allowed to rediscount stock exchange paper. It is difficult to follow Dr. Anderson through the peculiarly twisted reasoning which has led him to a conclusion directly at variance with the judgment of both theoretical and practical men regarding a great question of administration and management in banking. Further continuing the same line of thought, there is evolved the remarkable theory that no bank reserves are needed. This, indeed, could scarcely be believed, were it not expressly stated by the author in so many words (page 543), where he says: "As we approach static conditions, we need less and less gold reserve behind bank demand liabilities. The static law of bank reserves is that none are needed." This singular "law" should be placed side by side not only with the view that rediscount institutions should take up stock exchange paper, but also with other vagaries of thought which appear from time to time throughout the work.

It is no reflection upon Mr. Anderson or his work to say that the subject with which he deals is one of great breadth and difficulty, and that it has not yet been adequately presented.

H. PARKER WILLIS.

Washington, D. C.

ATWOOD, ALBERT W. *How to Get Ahead.* Pp. 277. Price, $1.25. Indianapolis: The Bobbs-Merrill Company, 1917.

Mr. Atwood has admirably succeeded in his purpose: to write a book "for young men and women of moderate earning capacity which will help them save and invest money."

The subject is approached with a sound knowledge of the principles involved, and Mr. Atwood, in his capacity as Lecturer on Finance at New York University, has come personally in contact with the group to which he writes. Intensely practical, the book contains various helpful suggestions as to budgeting, easy-term investments, etc. The names used to designate the different types of bonds, stocks, mortgages and insurance policies are carefully differentiated and explained.

"There is no great secret about earning money," says Mr. Atwood, "but it is a hard task to spend money judiciously after having earned it."

Perhaps because of the effort to be absolutely clear, the author gives way to somewhat needless repetition. It has neither literary merit nor new ideas; it simply states in clear, readable English the "hows" of saving and investment.

E. H.

BANCROFT, HUGH. *Inheritance Taxes for Investors.* (Second edition, revised.) Pp. 133. Price, $1.00. Boston: Houghton, Mifflin Company, 1917.

The author summarizes inheritance tax legislation passed in the United States and Canada down to January 1, 1917. Numerous tables show the state and national tax rates and brief comment is made upon the equity of the various laws. Considerable attention is given to state taxation of securities issued by domestic

corporations but belonging to the estates of non-resident decedents. The publication serves as a convenient handbook both to investors and to students of public finance. F. T. S.

COLLVER, CLINTON. *How to Analyze Industrial Securities.* Pp. 204. Price, $2.00. New York: Moody's Investors Service, 1917.

Investment banking houses make a rough classification of businesses for the purposes of financing which divides private corporations into railroad, public service and industrial. All corporations which are not railroad or public service are classed as industrials. Even mining corporations fall into this classification. Obviously, however, the wide variety of businesses called industrial makes the formulation of principles for analysis of industrial securities a more difficult matter than for securities which are based on a single kind of business, as that of the railroads. Public service corporations form a compact group of business resting on the same base and with many more points of likeness than of difference above their entirely common base. Besides the similarity of the businesses, the supervising bodies and the managers by agreement have come much nearer a uniform and complete accounting and publicity of that accounting than the so-called industrials. Industrial securities are for the most part later comers into the general investment market than either of the other classes. All these reasons account for the fact that so little has been done in any attempt to systematize the study of industrial securities.

Mr. Collver's book is a pioneer work and on that account much is to be forgiven it in the way of sketchiness. The student of securities owes the writer much for what he has accomplished. The most useful parts of the book are the brief chapters under the general heading of Business Factors on Fluctuations in Demand, Diversification (of product), Integration—Sources of Supplies, Standardization and Location, and on Competition, and certain suggestions on the study of the balance-sheet and income account.

HASTINGS LYON.

New York City.

ESCHER, FRANKLIN T. *Foreign Exchange Explained.* Pp. xii, 219. Price, $1.25. New York: The Macmillan Company, 1917.

Students of banking and foreign exchange will be inclined to consider this volume merely a revision and expansion of Mr. Escher's *Elements of Foreign Exchange.* This supposition is incorrect, as the book has been entirely rewritten. The order of the material has been changed, there are some condensations and numerous additions.

The treatment is still the most satisfactory introduction to the subject that we have in the United States. The author writes clearly and simply. Some topics, however, could have been covered more fully to the advantage of both academic and practical students of the subject. One of these is a more complete treatment of the exchanges during the war. Some aspects of this are undoubtedly of temporary rather than of permanent interest but others are more significant. Probably the most important of these is the growing extent to which governmental

(or central bank) fiat is the controlling force in gold movements rather than the fact that exchange quotations have reached the gold points. Profits in foreign exchange dealings formerly dependent on the movements of these exchange quotations are now determined by the principles guiding our federal reserve board and similar bodies in other countries. An analysis of this influence, which has been growing in significance for some years is greatly needed.

E. M. P.

Business Law

Huffcutt, Ernest W. *The Elements of Business Law.* (Revised by George G. Bogert.) Pp. xiv, 319. Price, $1.12. Boston: Ginn and Company, 1917.

A treatise such as this covering so many branches of the law, namely, contracts, sales, bailments, insurance, guaranty, negotiable instruments, agency, partnership, corporations and property, must of necessity deal very briefly with each of them. The author, however, has in part overcome the difficulty of limitation of space by adopting the plan of giving a very concise statement of the main principles of law, and illustrating the principles by short practical cases showing their application.

A feature of the book which is to be particularly commended is the plan of placing at the end of each chapter a number of concrete legal problems for solution by the student.

. The problems are well selected and should accomplish the aim of the author of schooling the student in the application of legal principles to every-day problems.

C. N. C.

Foreign Trade and Commerical Geography

Petersson, C. E. W. and Steveni, W. Barnes. *How to do Business With Russia.* Pp. xviii, 202. Price, $2.25. New York: Sir Isaac Pitman and Sons, Ltd., 1917.

This is a hand-book of substantial value to all who are interested in trade with Russia. About half of the book represents "a summary of the experience and business methods of Mr. C. E. W. Petersson, a merchant of Petrograd and Riga, who for many years carried on a large trade in machinery and kindred goods with various Russian towns." The remaining part, by Mr. Steveni, consists of a compact and illuminating description of the resources and business conditions of different portions of European Russia and of Siberia,—accurate, and suggestive of the immense wealth that lies idle for lack of development. Mr. Petersson's section (translated for this book) contains a great mass of details about business methods in Russia, and the banking and other machinery involved therein, together with sound and accurate advice as to legal remedies against Russian debtors. He does not mention, however, the very important law of August, 1916, by which the fraudulent transfer of property by debtors appears to have been made exceptionally difficult. Mr. Steveni points out the serious fact that previous Russian import tariffs have greatly interfered with imports into Russia, and suggets, what is unquestionably true, that Russia herself would be much better off by

making easier the import of machinery and other appliances on which her development is largely dependent. An item properly emphasized as of capital importance in trading with Russia, is the selection of agents, or agencies, to represent the foreign merchant or manufacturer. For Americans intending to enter the Russian trade, this point ought to be seriously—one might almost say prayerfully—considered. Business manners and methods in Russia are antipodal to those of America, and the wayfaring American exporter may readily go astray therein. To return to the book in hand, it is decidedly worth study. It is doubtful if any other on this subject in the English language is so full of good matter not otherwise readily accessible.

BENJAMIN BAKER.

Editor of "Russia,"
New York City.

INSURANCE

BLANCHARD, RALPH H. *Liability and Compensation Insurance.* Pp. xii, 394. Price, $2.00. New York: D. Appleton and Company, 1917.

Under the above title is published a book of 286 pages of descriptive material and 108 pages of an appendix. The main body of the book is divided into three parts: Industrial Accidents and Their Prevention; Employers' Liability and Workmen's Compensation; Employers' Liability and Workmen's Compensation and Insurance. The Appendices are made up of the New York Workmen's Compensation Law and policy contracts for this kind of insurance applying to a manufacturer's risks, together with an index.

In Part One, the author discusses the extent, character, and prevention of industrial accidents, and the results of accident prevention.

In Part Two are considered such subjects as the Law of Negligence, the defects of employer's liability, the historical development of workmen's compensation, together with a discussion of the legislation and legal questions which have arisen as a result of the enactment of these laws.

The subject matter of Part Three is concerned with the insurance under employer's liability and workmen's compensation legislation, including such subjects as the policy contract, the determination of rates, and the reserves to be held.

The author has very well selected his material, and the general brevity of the treatment is to be commended. It would, doubtless, have been possible for the author to have written a book of much greater length, but his treatment will supply all the legitimate needs for the class room or for the general reader who wishes to acquaint himself with the development of insurance of this character, as well as the kinds which are now in force.

It is well known that there are many unsettled questions in this field of insurance, for example, whether workmen's compensation should be supplied by private companies or directly by the state, or such questions as the determination of the rates. The author does not attempt to dogmatize on these mooted questions.

At the close of the chapters, there is given a list of excellent references. One wonders why it seemed advisable to the author to divide 286 pages of material into twenty-two separate chapters. Some of the chapter headings seem unfor-

tunate, as, for example, Chapter 9, Chapter 10, and Chapter 11 in Part Two, each of which has a title "Workmen's Compensation Legislation in the United States and Territories."

In some cases the tables supplied are not legible and in a few cases there seems to have been careless proof reading. This, however, is a question of printing, rather than of the material, a minor defect which in no sense seriously weakens the general excellence of the book. The material, as a whole, is a very valuable addition to the sparse literature on insurance, and Mr. Blanchard is to be commended for making accessible in this field of insurance such an excellent, concise discussion of the subject. W. F. GEPHART.

Washington University.

MERCHANDISING: WHOLESALE AND RETAIL

HOTCHKIN, W. R. *Making More Money in Storekeeping.* Pp. xix, 364. Price, $3.00. New York: The Ronald Press Company, 1917.

This book lives up to the implication in its title: to help the storekeeper make more money. It is not a text on retail merchandising, but rather a series of inspirational editorials on nearly all phases of the business-getting side of modern storekeeping. The work is designed principally for the retail merchant and his employes, and it is especially helpful to the owners and employes of embryonic department stores. While not scientific in method, it is a book that would induce the retail merchant to make a scientific study of his business. It leads him to ask himself important questions about his business. For example: "Who doesn't buy in your store?" "What trade do you want?" "Do your people (meaning employes) believe in your store?" "What unprofitable departments can you kill?" Such questions are the titles of many chapters, the contents of which stimulate the merchant into an active desire for the solution of the problems the questions designate.

Although nearly all of the book is primarily inspirational both in material and in style of expression, there is a great deal of specifically instructive matter, especially in the parts on advertising and on the training of salespeople. In fact, throughout the book the author's long experience as advertising manager for John Wanamaker, New York, is evident in the wealth of concrete matter he presents. The policies and methods advanced are all in accordance with the best of modern practice in retailing. The material, however, could have been stated more scientifically and in much smaller space, although that treatment would probably have robbed the book of its power to stimulate, which is its prime purpose. H. MCJOHNSTON.

University of Illinois.

STATISTICS

COPELAND, MELVIN T. *Business Statistics.* Pp. xii, 696. Price, $3.75. Cambridge: Harvard University Press, 1917.

Professor Copeland's volume is undoubtedly a step toward meeting a need which has long existed for some discussion of the application of statistical methods

to the practical conduct of business. These methods have come to be quite generally applied in the management of all large corporations within recent years and the necessity for some available description of such applications, especially in colleges of business administration, has been apparent.

No criticism can be made of the arrangement of the selections included. There is an exposition of some fundamental statistical principles which are necessary as a basis for subsequent discussions, followed by a number of articles on the uses of statistics in advertising, retailing, cost accounting, factory administration and business organization. Great care and attention evidently has been given to the judicious selection of articles, the reason for the appearance of most of these being apparent. Some objection may be made, however, to articles dealing with costs, not on the ground of their usefulness but for the reason that this has usually been considered a field preëmpted by accountants. Thus Bowley draws a distinction between statistics and accounting on the ground of the relative exactness of the figures. While we may not agree with the correctness of this reasoning we may still recognize that beyond a certain point in this direction the statistician becomes an accountant. On the other hand statistical training is highly valuable to the accountant.

Among the contents special mention may be made of the very excellent introductions to the various portions of the volume by the editor and also of the valuable and interesting articles by Messrs. Watkins, Mitchell, Copeland, Gantt and Alexander. The relative appeal of the articles dealing with special fields of course will depend somewhat on the direction of one's interest. Taken as a whole this volume will be gratefully received by many who will find good use for it as supplementary reading in courses on statistics and by business men to whom it will afford suggestions as to practical applications of statistics in their daily work.

ROBERT RIEGEL.

University of Pennsylvania.

TRANSPORTATION

MACGILL, CAROLINE E. (prepared by: under the direction of B. H. MEYER). *History of Transportation in the United States before 1860.* Pp. xi, 678. Price, $6.00. Washington: Carnegie Institution of Washington, 1917.

This is the fourth study to be printed in the coöperative economic history of the United States, planned and financed by the Carnegie Institution of Washington, the three which have preceded this one dealing with the subjects of commerce, manufactures, and labor. It covers the subject of road, water (canal and river), and railroad transportation from the beginning of our national period to 1860. The colonial period is practically dismissed with a single sentence: "Prior to the Revolution inter-colonial commerce was inconsiderable, and inter-colonial trade routes, where they existed, were entirely inadequate."

A great deal of preliminary work had been done on the subject of this volume by a number of collaborators, in the preparation of special studies, and these have been used freely in the writing of the completed narrative by Miss MacGill. In spite of the skill with which she has used this material and her own contributions in filling in gaps, the work is rather uneven both in fullness and merit. The sec-

tions dealing with roads are the least satisfactory; the description of the internal improvements is compendious, but more attention is given to a full compilation of facts than to an economic analysis of the new system as an agency of transportation. The same criticism might be offered regarding the chapters on the early railways, though an attempt is made to evaluate their importance in a final chapter.

It is evident that every effort has been made to insure a dependable and accurate account of the development of transportation in this country, and in this respect the work is a success. It is a perfect encyclopedia of names and dates and facts. A forty-page bibliography, a full index, and some excellent railroad maps add to its usefulness. Probably more credit for its excellencies are due to the editor, Dr. B. H. Meyer, than the modest preface would indicate.

E. L. BOGART.

University of Illinois.

BARNEY, WILLIAM JOSHUA (Compiled by). *Selected Bibliography on Ports and Harbors.* Pp. 144. Price, $1.00. New York: The American Association of Port Authorities, 1916.

In this volume Mr. W. J. Barney, secretary of the American Association of Port Authorities, presents a selected list of references on the ports and harbors of the United States and the world's principal foreign maritime countries. It includes books, public and private reports, magazine articles, transactions of technical associations, statute citations and references to port regulations. The bibliographical list is divided into two parts: a place and subject bibliography. The former is classified by continents, countries and individual ports. The latter includes subjects such as port administration, free ports, belt lines, port and harbor engineering, costs, types of wharves, drydocks and freight handling facilities.

G. G. H.

ECONOMICS

CHAPMAN, S. J. *Outlines of Political Economy.* (Third edition, revised and enlarged.) Pp. xvi, 463. Price, $1.75. New York: Longmans, Green and Company, 1917.

Topical analysis and order of treatment are substantially the same in this as in the earlier editions. In many places there has been a rephrasing which improves the book for teaching purposes, and recent war developments have suggested additions which further contribute to the value of the volume. Two new, final chapters afford an interesting historical survey of economic doctrines.

R. C. McC.

GRUNZEL, JOSEF. *Economic Protectionism* (Ed. by Eugen von Philippovich). Pp. xiii, 347. Price, $2.90. New York: Oxford University Press, 1916.

To Dr. Grunzel, economic activity is of three kinds—private economy, world economy and national economy. When people dwell within a certain area under

a given political jurisdiction their common economic interests transcend in importance physical, religious and other differences, and the national economy becomes the dominant economic unit. World economy is still in a primitive stage of development and a quest for its principles is vain. Nevertheless, world economic relations increase in complexity and tend to break into the national-economy sphere and economic protectionism appears. This protectionism is "the totality of those measures by which the national economy seeks to promote its interests in the world field."

Protective policies may be applied either to encourage or to discourage the movements of (a) commodities, (b) capital, or (c) labor, and therefore protective measures may affect each of the three either in a positive or in a negative manner. Thus conceived, the field to be surveyed is broad. A nation may in a negative manner influence the movement of foreign commodities into the country by customs duties, adjustment of freight rates, through administrative regulations or by concerted popular action, such as the boycott of foreign goods. Positive measures having the same intent are export bounties, special freight rates on exports, shipping subsidies and bounties, and other measures. Similarly capital movements may be discouraged by the interposition of obstacles in the way of foreign enterprises, the exportation of domestic capital and denationalization of capital. It may be encouraged by still other measures. Labor movements into and out of a country may also be encouraged or discouraged.

Thus conceived, economic protectionism is a broad subject. It is treated under three headings: (a) its genesis, (b) the directions it has assumed and (c) its effects. Past theories of protectionism are inadequate, partly because they apply chiefly to protective duties alone and partly because they assume a non-existent internationalism. A new theoretical basis is found in the fact that large investments of capital make imperative the largest possible stable market. Stability of markets both qualitatively and quantitatively may best be assured by "securing the domestic market to the business of a country by political means."

Dr. Grunzel's volume is the strongest modern presentation of the argument for protectionism. Its conception is broad and its treatment thorough. The reader is never in doubt as to the author's attitude but this apparent prejudice in favor of protective measures does not destroy the value of the treatment.

E. M. PATTERSON.

University of Pennsylvania.

TREVER, ALBERT A. *A History of Greek Economic Thought.* Pp. 161. Price, 75 cents. Chicago: University of Chicago Press, 1916.

Dr. Trever furnishes the English reader with a treatment of Greek economic theorizing "written from the standpoint of the classicist, but with a view also to the needs of twentieth-century students of economics." There is much in his treatment that is of distinct service to the latter group and doubtless also to the former.

WALLING, WILLIAM E. and LAIDLER, HARRY W. (Ed.) *State Socialism, Pro and Con.* Pp. xliv, 649. Price, $2.00. New York: Henry Holt and Company, 1917.

State Socialism is defined as the policy of extending the economic functions of the state. Inasmuch as tendencies in this direction have been notable throughout the world for more than half a century, there is nothing new in kind about recent extensions of such activities. But the degree of progress has been so rapid since the beginning of the war that comprehensive samples of recent development are well worth collecting for general scrutiny and appraisal. Primarily a source book, with selections written by experts or skillfully chosen from official reports, the volume is in no sense a plea for collectivism. Its object is simply to show the spread of state socialism and to indicate the possible direction and extent of future growth.

Finance, transportation, the extractive and elaborative industries and social enterprises in the interest of the individual as citizen, consumer, producer and taxpayer, all receive illustrative handling which brings out the character and extent of recent collectivistic development. The task is well done. No attempt is made to force on the reader any particular point of view, but the mass of data leaves little room for doubt about what is really happening. Indeed, the accumulation of those data is so vast that the main field of usefulness of the book will doubtless be as a work of reference. R. C. McC.

POLITICAL SCIENCE

BARKER, HARRY. *Public Utility Rates.* Pp. xiv, 387. Price, $4.00. New York: McGraw-Hill Book Company, Inc., 1917.

GRUNSKY, CARL EWALD and GRUNSKY, CARL EWALD, JR. *Valuation, Depreciation and the Rate-Base.* Pp. viii, 374. Price, $4.00. New York: John Wiley and Sons, Inc., 1917.

Public Utility Rates is a discussion of the principles and factors underlying charges for water, gas, electricity, communication and transportation service. The author is an engineer and associate editor of the *Engineering News.* He is thoroughly informed and his book is replete with sound information. Any writer on this subject must, under present circumstances, expect to have his book examined closely whether he leans corporation-ward or public-ward. Mr. Barker has tried to steer his course between the two, but in case of doubt goes with the corporations. The author says, for instance, that some 5 per cent is not an unwarranted amount for omissions in inventories though 2 or 3 per cent would seem to suffice for a large property of comparatively few items, and 15 per cent may be fair at the other extreme of a smaller property with many and scattered items which are difficult to check up. Those familiar with the decisions on this matter will see that the author justifies a much higher percentage for omissions than is usually accepted by courts and commissions. The author's analysis of depreciation as it affects utility rates is particularly keen and worthwhile. That the book came out in the year 1917 is evidenced by the following statement: "There have been cases of vociferous demand for higher rates to prevent calamity, where equal energy applied at home to the study of organization of men and the use of

materials and labor would go a great way toward the desired goal of larger dividends." This is no doubt the best general book on public utility rates as distinct from railway rates that has yet appeared. The book is full of solid information. Very ample footnotes and references are a guide for checking up the sources and character of information.

Valuation, Depreciation and the Rate-Base, however, does not equal this contribution. Neither is it so well tempered with concern for the public interest as well as for the corporate interest. The book covers old ground and does not do that particularly well. There are some tables in the Appendix which will be of material value and assistance. These have to do with Probable Useful Life, Expectancy and Remaining Value, Amount of One Dollar at Compound Interest, Value of One Dollar Due at a Future Date, Amount of an Annuity of One Dollar, An Annuity Which Will Amount to a Dollar in a Given Time, Present Value of an Annuity of One Dollar, Annuity Which One Dollar Will Purchase, and Amortization and Depreciation. CLYDE L. KING.

University of Pennsylvania.

BEER, GEORGE LOUIS. *The English-Speaking Peoples.* Pp. xi, 322. Price, $1.50. New York: The Macmillan Company, 1917.

This volume covers nearly all those phases of international relationships which have significance for today or for the future, and will appeal to the widest possible group of readers. After two introductory chapters, whose theme is the necessity of modifying radically our present conception of unlimited sovereignty, if we are ever to achieve any sort of effective international organization, the writer in the following three chapters shows clearly how our initial reaction to the war, one of lofty sense of isolation, was the direct result of our century long consistent foreign policy of non-interference in European affairs.

It is in the last three chapters, however, that the author really presents his main thesis. This is that there exists a fundamental unity of racial, cultural, economic, and political interests among the various English-speaking peoples. This contention is driven home with such a wealth of illustration that its fundamental truth is proved beyond any serious doubt. One cannot urge too strongly the desirability of a more general appreciation among our fellow citizens of this essential community of interests.

The volume, made up as it is in part of articles previously published, suffers from a lack of coherence. This defect is made more evident by the author's tendency occasionally to elaborate his arguments unnecessarily. Despite these defects, this book must remain one of the most suggestive that the war has thus far inspired. J. G. McD.

JAMES, HERMAN G. *Municipal Functions.* Pp. xi, 369. Price, $2.00. New York: D. Appleton and Company, 1917.

Pope, I think it was, who, taking advantage of the license popularly granted his profession, once surveyed the field of municipal activities, and concluded:

Of forms of government let fools contest;
Whate'er is best administered is best.

We have many volumes that discuss the forms of municipal government, with detailed and comparative explanations of the powers and duties of the various officers, boards and commissions operating under any given system. With elaborations of the activities or functions themselves we have not been supplied so generously. This is the aim of Dr. James' book, and he has succeeded remarkably well. "Throughout this work but little attention has been devoted to the subject of governmental machinery, for the chief concern here has been to point out what every city should do no matter what form of government it might be operating under" (p. 347).

The author, however, does not agree with the poet's conclusion as to the organization of municipal government, observing "that while the end is much more important than the means, there may be a vast difference in the ease with which the end is to be accomplished, according to whether or not the most suitable means have been employed" (p. 347). This same spirit of intelligent toleration pervades all the many mooted questions discussed.

Municipal Functions surveys the field of the major activities of the typical city in such a way that it may be of great value as a guide to a college class in municipal administration. At the same time the average citizen will find it entirely readable. The relationship between success in management and the adoption of definite policies in municipal affairs is pointed out in every chapter. It is this feeling, unconsciously seeping into his mind, that will change the city dweller into a citizen.

The work of the various departments of the average city is taken up in detail. City planning, public morals, education, budgets and accounting, public works, health and safety are a few of the subjects given consideration. There has been a conscious omission of footnotes and bibliography.

Certain general conclusions are open to criticism. For example, there is ample reason for the contradiction of the statement (p. 146) in reference to prostitution. It is a recognized fact that it has not "been forbidden in every civilized country by law." Abraham Flexner, in *Prostitution in Europe* says: "In England, Italy, Norway, Holland and Switzerland there is no penal enactment against prostitution as such." In a memorandum to the Corporation of Glasgow, the Chief Constable declares: "Immorality in itself is no offense against the law." We are impressed, however, with the open mind with which the many controversial questions are approached. The author has no reformer's axe to grind at any point. In each case the facts are presented, pro and con, and the dogmatic conclusion, if there is to be one, is left to the reader for formulation.

H. G. Hodges.

Cleveland, O.

Kawakami, K. K. *Japan in World Politics.* Pp. xxvii, 300. Price, $1.50. New York: The Macmillan Company, 1917.

Mr. Kawakami, a partly American-educated Japanese, so far as his advanced work is concerned, and a follower of Karl Marx who has modified his extreme socialistic views after an extended residence in the western part of the United States and marriage to an American woman, has become a somewhat prolific

writer, not to say propagandist, on the subject of the diplomatic relations of Japan and America. Whether one reads his *Asia at the Door*, his *American-Japanese Relations*, the present work, or his *Modern Germany* and other attempts in Japanese, the reader will be impressed with the same note through all of apologetics for his native land or the lament that neither has the United States nor have other Western Powers admitted Japan without reservation and fully into the comity of nations or to a complete social and legal equality. The author's announced and laudable motive is to promote friendly relations and good feeling between the United States and Japan, the two nations most concerned in the political and economic questions that determine the future of the lands bordering on the Pacific Ocean. The whole viewpoint, however, is essentially Japanese and asserts the following disputable and in my opinion untrue major premise that Japan has not received a square deal from America. This unhistorical attitude somewhat minimizes the author's chance of becoming the ideal interpreter of rational relations between the two countries, such as are typified in the Root-Takahira and Lansing-Ishii "gentlemen's agreements" which have signalized and emphasized the personal and national attitudes of America to Japan under the Roosevelt and Wilson administrations. It is safe to say that this attitude has never seriously varied since the days of Commodore Perry, on the part of the United States at least. Mr. Kawakami's book will and should be read, however, by all those who wish to be informed on moderate Japanese opinion on certain controverted diplomatic or economic questions between the two governments, especially on those relating to California, Mexico, the Philippines, China, and German ambitions and dastardly intrigue. It offers some antidote to the Jingoistic utterances, writings and doings of certain American, Japanese and German trouble-makers.

Mr. Kawakami has a personal axe to grind also because he desires to become a naturalized citizen of the United States and he regards our attitude against naturalization as the real menace to our future relations with Japan. Equally as fantastic is his doctrine that Japan, the most serious enemy of the "Open Door" in China and the chief power threatening Chinese "integrity," prior to Mr. Lansing's agreement with Ishii, has been the sole nation to fight to maintain these principles. The "Open Door" is well known as an American policy begun in the American-Chinese Treaty of Wang Hia and emphasized by John Hay.

J. C. BALLAGH.

University of Pennsylvania.

LAPP, JOHN A. (Compiled by). *Important Federal Laws.* Pp. xv, 933. Price, $6.00. Indianapolis: B. F. Bowen and Company, 1917.

In this volume Mr. Lapp, whose legislative work is widely known, seeks to give within the compass of less than one thousand pages a compilation of the more important recent federal laws. He has succeeded admirably, has used excellent judgment in the selection of statutes and in summarizing, where this is necessary. The result is a remarkably compact and handy volume printed in clear, large type on thin paper,—a book that will be indispensable to the banker, the journalist, the lawyer, the lecturer, the teacher and the advanced student of social science. It will also prove a valuable reference work for general libraries.

The statutes cover a wide range of subject matter and are grouped together under the following heads: Agriculture, Vocational Education, Banking, Immigration and Naturalization, Business Regulation, Food and Drugs, Labor, Taxation, Commerce, Elections, National Defense, Trade Marks and Copyrights, Moral Reform, Bankruptcy, Criminal Code, Judicial Code, Health and Roads. Within these groups all statutes of importance up to those passed in the early summer of 1917 are given. Some interesting facts stand out from a perusal of these laws. Most of them have been passed or revised since 1910, showing how recent is the main body of regulative statutes. They provide for an extensive increase in the national administrative machinery to carry out their enforcement. A large proportion of them are based upon the federal power to regulate commerce, although many are not commercial in their chief purpose. While the legislation since the date of publication has been extremely important, especially in the field of taxation, the present compilation is highly satisfactory in all respects. Professor Lapp has performed a real service in selecting and bringing together in this convenient form the chief federal measures of present interest.

James T. Young.

University of Pennsylvania.

Root, Elihu. *Latin America and the United States.* Pp. xvi, 302. Price, $2.50. Cambridge: Harvard University Press, 1917.

Of the many notable addresses delivered by Mr. Root as Secretary of State and as a member of the United States Senate, certainly none have had a larger international influence than the series of remarkable speeches which he delivered during his tour through South America at the time of the Third Pan-American Conference held at Rio Janeiro in 1906. These addresses possess a significance far deeper than the mere formal greetings of a distinguished representative of the government of the United States. They breathe, not only a broad patriotism, but carry to our sister republics a message of true friendship and helpfulness. They mark a distinct epoch in the attitude of these nations toward the United States.

In Mr. Root's addresses there is totally absent that spirit of condescension characterizing so many American utterances; an attitude which has done much injury to our relations with Central and South America. Particularly notable is the address delivered at the Third Pan-American Conference. On this solemn occasion he summarized in admirable form the spirit which should dominate the relations of the American countries with one another. This one address should be read and re-read by the American people, and it is no exaggeration to say that future generations will find therein the best and highest expression of American foreign policy.

L. S. R.

Roxburgh, Ronald F. *International Conventions and Third States.* Pp. xvi, 119. Price, $2.50. New York: Longmans, Green and Company, 1917.

This is another addition to the series of contributions to international law now being brought out under the editorship of Professor Oppenheim of Cambridge University. Inasmuch as it deals with only one of the multifarious questions of

international law, it will appeal to the specialist rather than to the general student of international law. The author undertakes to answer a question which has never heretofore been the subject of research: What is the effect of international conventions on other states than those which are parties thereto? Recently this question sprung into importance by the case of *Costa Rica* v. *Nicaragua* before the Central American Court of Justice in which the Court held that the Bryan-Chamorro treaty of August 5, 1914, between the United States and Nicaragua violated certain rights of Costa Rica. The author reviews the principles laid down in the municipal laws of the more important states so far as they deal with the matter. He then summarizes and criticizes the opinions of the jurists and text writers who have previously considered the subject. Finally, he examines the precedents that have arisen in diplomatic practice, and on the basis of the information obtained from these three sources, he formulates his own conclusions.

Altogether the monograph throws much light on a hitherto neglected subject and as such it is a distinct contribution to the literature of international law. It contains a valuable bibliography of the authorities who have heretofore touched upon the question which he attempts to answer. J. W. G.

SOCIOLOGY

ELLWOOD, CHARLES A. *An Introduction to Social Psychology.* Pp. xiii, 343. Price, $2.00. New York: D. Appleton and Company, 1917.

This is virtually a revised edition of the author's *Sociology in its Psychological Aspects* published in 1912. The subject matter has been somewhat modified and rearranged; the terminology varied; but the viewpoint is unchanged. The style is clear. The author knows the other writers in his field and presents their views accurately. He uses ordinary terms wherever possible and for this deserves much credit.

The first three chapters are introductory. In them are sketched social psychology, the evolution of organisms, and the nature of human society. In the next five chapters the nature of social unity is discussed at length as is also social change under normal and abnormal conditions. In the succeeding chapters special topics, such as the rôle of instinct and intelligence, imitation and suggestion, sympathy and consciousness of kind are treated, the closing chapter being in reality a summary on the nature of society.

It would be easy for the reviewer to discuss at length many of the views presented and to question certain of the conclusions reached. For instance the hedonistic explanation of conduct is rather lightly disposed of on the ground of the inborn activity of the organism without regard to external stimulus. I am not convinced that the problem ends there. The great question which comes to the mind is not concerned with the author's positions but has to do with the reliability of the data presented by psychology on which social psychology must be based. Here I have many doubts. Admitting this situation, I must compliment Dr. Ellwood on his ability to select and present his material. His discussion is timely and stimulating.

CARL KELSEY.

University of Pennsylvania.

HAMMOND, J. L. and HAMMOND, BARBARA. *The Town Labourer 1760–1832.* Pp. xi, 346. Price, $3.50. New York: Longmans, Green and Company, 1917.

In the ANNALS for July, 1912 the reviewer had the privilege of calling attention to a previous volume, *The Village Labourer*, by these authors. The high standards set in the first work are maintained in the present study. It is scholarly and accurate; careful references being given to the authorities cited. It is very readable and full of human interest. The authors are to be congratulated upon their success in telling us of the life of the working people during one of the most important eras in English history. The problems created by changing industrial conditions are carefully analyzed and the mental attitude of the various groups clearly set forth. In fact, I think that this fair statement of the motives actuating the governing class, masters and workmen is probably the greatest contribution the authors have made.

From the rise of the manufacturing town, the book proceeds to describe the administration of justice, the rise of the trade unions, the employment of children in mills and mines. Attention then is turned to the attitude of the rich, their conscience, their philanthropy. Next follows the consideration of the resources of the poor, their spirit of union and religion, their ambitions. Incidentally considerable light is thrown upon various more or less well known personages.

The volume will be of interest and value to all who are concerned with industrial history or who desire to know more of the backgrounds of important social questions.

CARL KELSEY.

University of Pennsylvania.

LOCK, R. H. *Recent Progress in the Study of Variation, Heredity and Evolution.* (Fourth edition, revised by L. Doncaster.) Pp. xxiv, 336. Price, $2.00. New York: E. P. Dutton and Company, 1916.

The purpose of the new revision of this work has been to make the smallest number of changes "consistent with giving a true idea of the present state of our knowledge." It is designed primarily to give a summarized description of the field of variation, heredity and evolution from the viewpoint of Mendelism. The terminology is somewhat simplified to serve the purposes of the general reader as well as the scientific public. The book is a useful summary of the field discussed from an up-to-date point of view.

J. G. S.

RICHMOND, MARY E. *Social Diagnosis.* Pp. 511. Price, $2.00. New York: Russell Sage Foundation, 1917.

No task could be more difficult than that which Miss Richmond has undertaken; the reduction of the "rule of thumb" knowledge of case workers to a statement of the general principles on which all good case work, whether with the widow, the neglected child, or the homeless man, must rest.

This book is the ripe product of fifteen years of study and experience of one who has done much to develop and standardize methods of social case work. Social workers have waited for the publication with eagerness, and have found in it just the summary of the common knowledge, the fundamentals of case diag-

nosis which they most need in their daily work, in the training of volunteers, and in the more theoretical discussions of the class room.

The book is divided into three parts. In the first the nature and uses of case evidence are discussed with a summary of those lessons which medicine and the law have taught. In the second part the processes which lead to accurate case diagnosis are examined and the value of the various sources of evidence—friends, relatives, social agencies, etc.—is weighed. In the third part a set of type questionnaires is given for use by the worker dealing with any one type of disability, such as the unmarried mother, or the alcoholic, or the blind.

The title of the book is perhaps misleading, as the author does not discuss group relations and their influence on the individual, neither is there any implication that the maladjustments and misfortunes of the individual are more often due to social causes beyond his control than to personal weaknesses and defects. The book is entirely concerned with the principles involved in personal work with people in distress, and the various individual readjustments that might restore them to a normal status in the community.

While the book is distinctly a text-book and technical in character, it is so liberally sprinkled with illustrations from the daily experience of case workers, that it makes most interesting reading even for the layman, and will undoubtedly have a wide public appeal. HELEN GLENN TYSON.

State Supervisor, Mothers' Assistance Fund,
Harrisburg, Pa.

VOGT, PAUL L. *Introduction to Rural Sociology.* Pp. xvi, 443. Price, $2.00. New York: D. Appleton and Company, 1917.

An introductory chapter, dealing with practical topics, is followed by a study of geographic environment in Chapter II. Chapter III deals with the improvement of agricultural methods, including the social effects of these improvements; Chapter IV, with good roads, the automobile, the telephone, and other means of communication, together with their effect on rural welfare; Chapters V and VI treat the land question, farm wages, and farmers' incomes; Chapter VII, population movements, including the cityward drift. Chapters VIII to XI deal with physical, mental and moral conditions of rural populations The next eight chapters are devoted to rural organizations: political, economic, social, educational and religious. In Chapters XX to XXV, Dr. Vogt deals with the rural village, which he has wisely included in this work because the rural village is a component part of the agricultural community, although it is seldom adequately discussed in similar works and in courses in rural sociology.

Chapter XXVI takes up the reverse side of the rural problem, including the question of superiority of country or city birth, leadership, the rural exodus, and the social results of each. The last chapter discusses the rural survey as a means of approach to the rural problem.

At the end of each chapter are a few well selected references. Questions for study emphasize important points in each chapter, and should prove of great help to the instructor using rural sociology as an introductory course. The topics for research give valuable suggestions for field work and for special papers.

The book is written and arranged so well that anyone whose business it is to deal with rural problems will be able to follow his interest without having to be thoroughly versed in sociological theory. Yet the teacher of sociology will note many leads in the text that will enable him to link up in the minds of his students the practical discussions of the book with the principles of sociology. This is especially valuable, as so much called "applied sociology" seems to present no idea of the application of sociological principles.

HOWARD WOODHEAD.

University of Pittsburgh.

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